



◆ **Monetary Policy Report** ◆
N°08/2008

Document prepared for
the Bank Board
September 23, 2008





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LIST OF ABBREVIATIONS

BAM	:	Bank Al-Maghrib
CFG	:	Casablanca Finance Group
CLI	:	Cost of living Index
CNSS	:	Caisse nationale de sécurité sociale (National Social Security Fund)
CUR	:	Capacity utilization rate
DF	:	Deposit facility
DH	:	Dirham
ECB	:	European Central Bank
GDP	:	Gross domestic product
GFCF	:	Gross fixed capital formation
HCP	:	High Commission for Planning
HP	:	Hodrick-Prescott
ICT	:	Information and communication technologies
IMF	:	International Monetary Fund
IPI	:	Import price index
IPPI	:	Industrial producer price index
LI	:	Liquid investments
LW	:	Liquidity withdrawal
MASI	:	Moroccan All Shares Index
MPR	:	Monetary Policy Report
NFA	:	Net foreign assets
OCP	:	Office chérifien des phosphates
OECD	:	Organization for Economic Cooperation and Development
TB	:	Treasury bills
UCITS	:	Undertakings for collective investment in transferable securities
VAT	:	Value added tax

TABLE OF CONTENTS

List of charts, tables and boxes	5
Press release	9
Overview	11
1. Supply and overall demand trend	13
1.1 Output	13
1.2 Consumption	16
1.3 Investment	17
1.4 Foreign trade	18
2. Pressures on output capacity and labor market	21
2.1 Pressures on output capacity	21
2.2 Pressures on labor market	22
3. Import prices	25
3.1 World inflation	25
3.2 Oil prices	26
3.3 Commodity prices	27
3.4 Import price indexes	28
4. Monetary conditions and asset prices	32
4.1 Monetary conditions	32
4.2 Asset prices	38
5. Recent inflation trends	41
5.1 Inflation trends	41
5.2 Goods and services	42
5.3 Tradable and nontradable goods	43
5.4 Industrial producer price index	43
6. Inflation outlook	46
6.1 Baseline scenario assumptions	46
6.2 Inflation outlook and balance of risks	48

LIST OF CHARTS

Chart 1.1	: Quarterly change in overall agricultural and non-agricultural GDP	14
Chart 1.2	: Change in building and public works' value added and in annual cement sales	15
Chart 1.3	: Annual change in cereal production and agricultural value added	15
Chart 1.4	: Year-to-year change in the value added of some activity branches	15
Chart 1.5	: Contribution of activity branches to overall growth	15
Chart 1.6	: Year-to-year quarterly change in household final consumption, consumer loans and travel receipts	16
Chart 1.7	: Year-to-year quarterly growth of gross fixed capital formation, non-agricultural value added, and equipment loans	17
Chart B 1.1	: Value added sectoral breakdown	19
Chart B 1.2	: Value added structure per institutional sectors	19
Chart B 1.3	: Sectoral breakdown of household final consumption	20
Chart B 1.4	: GFCF sectoral breakdown	20
Chart B 1.5	: GFCF breakdown per institutional sectors	20
Chart 2.1	: Overall output gap	21
Chart 2.2	: Non-agricultural output gap	21
Chart 2.3	: Lagged non-agricultural output gap and core inflation	21
Chart 2.4	: Industrial output capacity utilization rate	22
Chart 2.5	: Apparent labor productivity	22
Chart 2.6	: Change in unit production cost components	22
Chart 2.7	: Employment and unemployment rate in urban areas	23
Chart 2.8	: Net job creation per sector of activity	23
Chart 2.9	: Change in wage level and in employed labor force in the industry	24
Chart 2.10	: Quarterly minimum wage in nominal and real terms	24
Chart 3.1	: World oil price and pump price in Morocco	25
Chart 3.2	: Fuel pump price and transportation price	26
Chart 3.3	: Price index of food commodities and wheat	27
Chart 3.4	: Commodity price index excluding energy and metals	27
Chart 3.5	: Import price index excluding energy	27
Chart 3.6	: Food import price index	28
Chart B 3.1	: Market shares of Morocco's main suppliers excluding energy	29
Chart B 3.2	: Structure of Moroccan imports from China	29
Chart B 3.3	: Moroccan index of Chinese import prices.....	30
Chart B 3.4	: Moroccan index of Chinese import prices of final consumption goods	30
Chart B 3.5	: U.S. index of Chinese import prices	30
Chart 3.7	: Mining products' import prices	31
Chart 3.8	: Import price index of semi-finished products	31

Chart 4.1	: Change in interbank rate	32
Chart 4.2	: Change in interest rates' structure per maturity on the Treasury securities market.....	33
Chart B 4.1	: Change in liquidity position and in weighted average rate	33
Chart B 4.2	: Liquidity position and weighted average rate of the interbank money market	34
Chart B 4.3	: Change in reserve requirements	34
Chart B 4.4	: Change in liquidity factors effect	34
Chart B 4.5	: BAM interventions on the money market	34
Chart B 4.6	: Change in the mean and standard deviation of the interbank market weighted average rate	34
Chart 4.3	: Change in lending rates	35
Chart 4.4	: M3 annual growth and trend	35
Chart 4.5	: Money surplus	35
Chart 4.6	: Annual growth of M3 components	35
Chart 4.7	: Annual growth of nonfinancial agents' demand deposits	36
Chart 4.8	: Bank loans' annual growth and trend	36
Chart 4.9	: Loans' structure per economic agent	36
Chart 4.10	: Annual growth of net foreign assets	37
Chart 4.11	: Quarterly change in net claims on the Government	37
Chart 4.12	: M3 growth breakdown per main counterparts	37
Chart 4.13	: Annual change in liquid investments	37
Chart 4.14	: Change in monetary and bond UCITS securities	38
Chart 4.15	: LI4 and Masi	38
Chart 4.16	: Exchange rate of the dirham	38
Chart 4.17	: Nominal and real effective exchange rate	38
Chart 4.18	: Stock market indexes.....	39
Chart 4.19	: Stock market capitalization/GDP	39
Chart 5.1	: Headline inflation and core inflation.....	41
Chart 5.2	: Contribution of the main components to year-to year headline inflation	41
Chart 5.3	: Relative prices of processed goods and services excluding private transport in comparison to headline inflation	42
Chart 5.4	: Contribution of goods and services prices to headline inflation	43
Chart 5.5	: Gap in inflation rates between processed goods and services excluding private transport	43
Chart 5.6	: Change in the indexes of tradables and nontradables	43
Chart 5.7	: Change in the contribution of tradables and nontradables to headline inflation	43
Chart 5.8	: Change in industrial producer price indexes	44
Chart 5.9	: Contribution of the main headings to manufacturing producer price index	44
Chart 5.10	: Refining industry index and Brent prices	44
Chart 5.11	: Change in food prices in Morocco and on international markets	45
Chart 6.1	: Inflation forecast fan chart, 2008 Q3 - 2009 Q4	49

LIST OF TABLES

Table 1.1 : Year-to-year growth of quarterly GDP at 1998 chained prices per major activity branches	13
Table 1.2 : Cereal production	14
Table 1.3 : Trade balance growth between January and July.....	18
Table 2.1 : Activity and unemployment quarterly indicators per place of residence	23
Table 3.1 : Recent evolution of world inflation	25
Table 3.2 : Oil price forecasts	26
Table 3.3 : Domestic selling price of oil products	26
Table 3.4 : Change in wheat futures and forecasts	27
Table 4.1 : Change in short-term TB yield rates on the primary market	32
Table 4.2 : Borrowing rates	33
Table 4.3 : Change in the main bank loan categories	36
Table 4.4 : Equity market valuation	39
Table 5.1 : Headline inflation and its components	42
Table 5.2 : Price indexes for goods and services	42
Table 6.1 : Inflation central forecast for 2008 Q3 - 2009 Q4	48

LIST OF BOXES

Box 1.1 : Structure of the Moroccan economy according to the national accounting system	19
Box 3.1 : Chinese exports, import prices and inflation	29
Box 4.1 : Liquidity and implementation of monetary policy	33
Box 4.2 : Main provisions of the code of ethics on financing real estate assets adopted in May 2008	40

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PRESS RELEASE

BANK AL-MAGHRIB BOARD MEETING

1. The Board of Bank Al-Maghrib held its quarterly meeting on September 23rd, 2008.
2. The Board examined the development of the economic, monetary and financial situation since its last meeting held on June 17th, 2008, as well as the forecasts prepared by the Bank staff up to the fourth quarter of 2009.
3. Under the effect of the materialization of some risk factors identified during its June meeting, the Board noted that pressures on prices have increased. Year-to-year headline inflation stood at 4.8% in August 2008, 5.1% in July and 4.7% in June, while core inflation, which has remained substantially above 4% since March 2008, reached 4.4% in August.
4. The Board considers that this trend is largely explainable by the persisting direct and indirect spread effects of the prices of imported commodities and oil on inflation. Available data and analyses also show the continuing diffusion of price rises of tradables to nontradables, particularly services. Pressures on prices are even more noticeable in industrial producer prices, as manufacturing industries' index was up by 28.2% after a rise of 26.5% in June.
5. Parallel to this, macroeconomic fundamentals remain solid. In fact, the data published since the last Board meeting, as well as the macroeconomic forecasts of Bank Al-Maghrib, seem to confirm a significant economic recovery driven by demand, despite the global growth slowdown, especially in the Eurozone, our main partner. This trend is reinforced by the continuing strength of credit which grew, on a year-to-year basis, by 25.4% in July, after 28.7% in the second quarter.
6. Compared to June 2008, the central forecast has been revised upwards. Over the forecast horizon, it rose from an average of about 2.5% to a growth pace slightly below 4%. In the fourth quarter of 2009, it is expected to remain at a pace above 3%, year-to-year, in spite of the significant contraction of world growth, the expected deceleration of import price rise and the continuing contraction of money surpluses.
7. Over the forthcoming quarters, risks surrounding the central forecast continue their upward trend. Externally, they are linked to the future change in hydrocarbon and commodity prices. Internally, they are attributable to the impact of world prices on the subsidization system, to the rapid pace of credit growth as well as to the increasing pressures from the labor market.
8. In this context characterized by an upward-oriented inflation outlook and risk balance, the Board deems it crucial to contain second-round effects by limiting risks on price stability in the medium term, in order to protect the purchasing power and maintain the prerequisites for a sustainable growth.
9. Consequently, the Board decided to raise the key rate by 25 basis points, to 3.50%, while remaining highly vigilant on inflation trends and risk factors over the forthcoming months.

Rabat, September 23rd, 2008

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OVERVIEW

Under the effect of the materialization of some risk factors identified in the June edition of the Monetary Policy Report, pressures on prices increased in July 2008. Headline inflation stood at 5.1% on a year-to-year basis, after having reached 4.7% in June and 5.4% in May in view of the continued price rise in staple food and the increase in the prices of some fuels. Higher prices of fresh foods also contributed to this trend. Core inflation maintained a high growth pace on a year-to-year basis, at 4.7% after 4.8% in June and 4.9% in May. Further, the breakdown of headline inflation per type of product suggests the continuation of the spread effect of tradable prices to nontradables, particularly services. Pressures on prices are also perceptible at industrial producer prices, with manufacturing industry index up by 28.2%, after a 26.5% rise registered in June. Indeed, taking account of the rise in import prices, input costs of manufacturing businesses registered a sharp rise the effect of which was felt on industrial producer prices, particularly in the refining, food, chemical and metallurgical industries.

The data available and the macroeconomic projections for 2008 tend to show a recovery in domestic economic activity, in spite of the slowdown in economic activity in the Eurozone. At the sectoral level, it is mainly driven by the rebound of activity in the primary sector, the continued strength of non-agricultural activities and the strength of consumption and investment. Indeed, after moving ahead by 7% in the first quarter, growth is expected to stand on average at 6.7% in the second and third quarters of 2008 and around 6.5% for the year as a whole.

In these conditions, the overall output gap, according to the estimates of Bank Al-Maghrib, showed a positive value during the second quarter of 2008. The non-agricultural output gap also showed a positive value above the one registered over the same period of the preceding year. The trend of these two indicators should continue in the remainder the year. As for the output capacity utilization rate in the industrial sector, it rose at the end of July 2008 after the drop reported in the previous month. In this context, labor market conditions saw improvement in the second quarter of 2008. Furthermore, as mentioned in the previous Monetary Policy Report, the increase in the minimum wage in July 2008 and 2009 will have a significant and long-lasting effect on inflation. Overall, analysis of all the said indicators suggests an intensification of pressures on prices over the forthcoming quarters.

At the monetary level, the latest available figures show that monetary conditions saw no significant change since the last MPR. Indeed, they remain marked by the continuation of both the slowdown in money growth and the strength of credit, whose growth pace has slightly slowed down. M3 growth pace fell back to 12.2% in July, after an average of 13.8% in the first quarter, thereby reducing the extent of money surplus. Even though their expansion remains relatively strong, bank loans were slightly down in July on a year-to-year basis, with the fallback of growth in most credit categories and the contraction in non-performing loans' outstanding. Loans to businesses remain preponderant and are indicative of the sustained contribution of credit to strengthening output and investment. However, they may register some slowdown over the forthcoming quarters on the basis of the conclusions of the survey conducted by BAM among the banking system.

With regard to the lending rates, the results of the BAM survey suggest they went down between the first and second quarter of 2008, returning to their average level observed since the second quarter of 2007.

On the basis of all of these items and in comparison with the forecasts outlined in the June 2008 MPR, the central forecast has been revised upwards given the materialization of some risks over the past few months. Over the forecast horizon, it indeed rose from 2.7% to 3.8% in this MPR. This update is attributable, on one hand, to the gap observed in the second quarter between actual and forecast inflation and, on the other hand, to the materialization of certain risks and a better visibility on the future development of some indicators, thereby modifying the assumptions adopted in our forecast models.

In the framework of this MPR, Bank Al-Maghrib presents an inflation projection with a fixed interest rate (key rate at 3.25%) over 6 quarters. Therefore, it does not take account of the decision taken at the Board meeting of September 23rd, 2008 raising the key rate from 3.25% to 3.50%. This extension of the forecast horizon should make it possible to have better visibility on future inflationary trends.

On the assumption of non-materialization of the main risks identified, the central inflation forecast over the next six quarters on average stands at 3.8%. For the third quarter of 2008, we anticipate a rebound in headline inflation of 4.6%. In the fourth quarter of the current year, the central forecast is 4.2%. For 2008 as a whole, it is expected to reach 3.9% on average, a level significantly above the pace expected in the previous Monetary Policy Report, while in the fourth quarter of 2009, it would hover around 3.5% on a year-to-year basis.

For the forthcoming quarters, the risks and uncertainties surrounding the central inflation forecast remain tilted to the upside. Externally, they are linked to future trends in the prices of hydrocarbons and agricultural products and commodities. Internally, they arise from uncertainties on the changes that will be made to the range of subsidized oil products, loans' growth pace that remains high as well as the expected repercussions of the rise in the minimum wage on salaries.

1. SUPPLY AND OVERALL DEMAND TREND

The rebound in domestic economic activity in 2008 is being confirmed, in spite of growth slowdown in the Eurozone, our major economic partner. After having grown by 7% in the first quarter, domestic growth should stand on average at 6.7% in the second and third quarters. It remains stimulated by the rebound in primary sector, the continued strength of non-agricultural activities and the strength of consumption and investment. The contribution of foreign trade to growth remains negative, as the rate of coverage at the end of July fell from 51.3% to nearly 50.8%. According to our projections, the Moroccan economy's growth rate in 2008 would settle at around 6.5%.

1.1 Output

On the basis of BAM forecasts, economic activity is thought to have been stimulated in the first half of 2008 by a rebound in the agricultural sector, driven by the strengthening of cereal output, and by the strength of non-agricultural activities. Despite the slowdown in European growth, domestic growth rate throughout this period saw a rise of approximately 6.9% underpinned by a buoyant domestic demand.

Indeed, after having risen by 9.5% in the first quarter of 2008, agricultural value added grew by 10.2% in the second quarter and is expected to increase by 9.6% in the third quarter, suggesting an improvement in agricultural activities in 2008. According to the most recent figures of the Ministry of Agriculture and Marine Fisheries, cereal production for the 2007-2008 crop year reached 51.2 million quintals instead of 23.5 million in the previous year. Improvement of rainfall indicators during the previous crop year largely contributed to this outcome. However, these results remain below the average registered in the past five crop years, amounting to 62.8 million quintals. Out of the total cereal harvest, soft wheat represents 49% whereas durum wheat and barley represent 24% and 26%, respectively.

At the end of citrus fruit and early vegetable export campaign, foreign sale of citrus fruit shrunk by 9% whereas that of early vegetables increased by 14%. As for breeding, the activity is expected to grow further under the effect of the availability of livestock feeding and the improvement in poultry production.

After the 44.7% performance in the first quarter, fishing activity is expected to continue its strength in 2008, although at a slower pace. Its value added is expected to rise by 20% and 17% in the second and third quarters, respectively. Unloadings of

Table 1.1 : Year-to-year growth of quarterly GDP at 1998 chained prices per major activity branches

Activity branches	2007*				2008		
	QI	QII	QIII	QIV	QI	QII(P)	QIII(P)
Agriculture	-18.8	-21.6	-21.7	-21	9.5	10.2	9.6
Non-agricultural value added	5.7	6.1	6.4	6.4	6.5	5.1	5.0
Fishing	-15.3	-3.3	-15.1	-8.5	44.7	20.0	17.0
Industry (excluding oil refining)	3.1	4.4	4.1	5.0	5.3	4.5	4.9
Oil refining and other energy products	25.7	32.4	66.1	56.5	23.1	15.0	10.0
Electricity and water	7.5	5.7	9.1	1.0	6.6	5.0	4.8
Building and public works	11.2	14.1	11.7	9.8	10.3	8.9	9.6
Trade	2.0	2.2	2.4	3.2	5.1	4.4	4.3
Hotels and restaurants	6.7	1.8	4.8	3.2	-1.8	-0.3	0.4
Transportation	7.5	6.9	8.7	10.2	6.2	6.0	5.7
Post and telecommunications	10.6	10.5	10.4	10.2	11.0	10.6	11.0
Financial activities and insurance	16.2	18.0	19.1	21.3	20.2	16.2	15.5
Services to businesses and private individuals	7.3	7.7	8.1	8.2	6.8	5.4	5.2
General government and social security	2.1	2.4	2.8	2.8	5.7	3.6	3.4
Education, health and social action	7.3	7.9	7.9	8.7	4.5	3.7	3.5
Taxes on products net of subsidies	12.0	12.3	8.1	10.0	6.6	5.6	5.5
Gross domestic product	3.0	2.6	2.5	2.7	7.0	6.8	6.7

(*) (*) The quarterly national accounts have seen substantial revisions as of the first quarter of 2006. By way of example, GDP growth rate in the first quarter of 2007 was revised upwards by 1.1 percentage point (3% instead of 1.9%) and 0.9 percentage point in the second quarter (2.6% instead of 1.7%). The oil refining, fishing and mining activity branches saw the highest revisions.

Sources: HCP; BAM forecasts

coastal and traditional fishing at the end of July grew by 12% in volume and 38% in value, thus amounting to 356,197 tons worth 2.8 billion dirhams.

Parallel to this, the value added of non-agricultural activities is expected to increase during the second and third quarters, to reach 5% on average, a performance nearing that of 5.5% registered over the past two years.

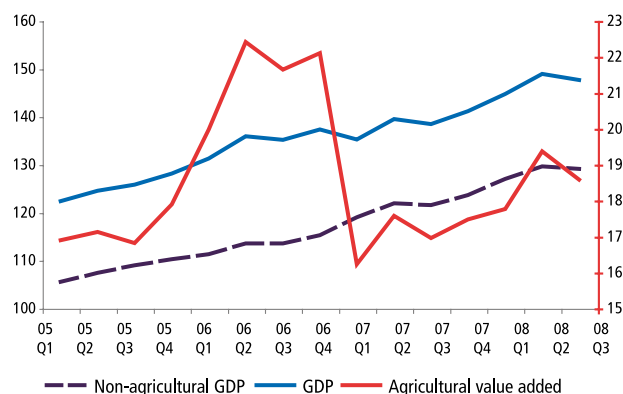
The value added of mining activities is expected to rise by 3.1% in the third quarter, which represents a growth rate relatively close to that registered in the second quarter. Phosphate exports, the volume of which increased by 1.4%, more than tripled between July 2007 and July 2008, in connection with sharp rise in the price of crude phosphates. In one year, this went on average from 80 dollars per ton up to over 367 dollars.

As to energy activity, it is expected to remain well oriented in the third quarter of 2008 moving on a year-to-year basis by nearly 5% in connection with the good direction taken on by refining activities and the consolidation of the value added of the «electricity and water» branch.

Concerning the value added of industrial activity excluding petroleum refining, it should strengthen over the second and third quarters, with an average growth pace expected to be of 4.7%. This performance is thought to be linked to that of the agri-food business, which was positively impacted by the agricultural sector's results. Several items of information seem to confirm this trend. Exports of finished capital goods were up by 14.4% in July, in connection with higher exports of wires and cables for electricity and industrial vehicles. The results of BAM business survey in the industry, for the same month, show an improvement in overall sales and orders as well as an increase in prices. Moreover, output capacities utilization rate remained unchanged at 72%. Excluding refining, this rate stood at 74%.

Building and public works' activity should confirm its favorable orientation in the second and third quarters, with value added increasing by 8.9% and 9.6%, respectively. This trend is thought to be linked to the persistence of high demand for new housing, the sustained growth in real estate

Chart 1.1: Quarterly change in overall agricultural and non-agricultural GDP, in billions of dirhams



Sources : HCP, BAM forecasts

Table 1.2 : Cereal production (final data)

	Crop year 06-07			Crop year 07-08		
	Production (1000 qx)	Surface area (1000 ha)	Yield (qx/ha)	Production (1000 qx)	Surface area (1000 ha)	Yield (qx/ha)
Fall cereals						
Soft wheat	10 688	1 729	6.2	25 295	1 930	13.1
Durum wheat	5 138	843	6.1	12 400	928	13.4
Barley	7 626	1 993	3.8	13 532	2 181	6.2
Total	23 452	4 565	5.1	51 227	5 039	10.2

Source : Ministry of Agriculture and Marine Fisheries

loans and the continuation of major infrastructure projects. In July, cement sales grew by 15.3%, at almost the same pace as that observed in the first half year.

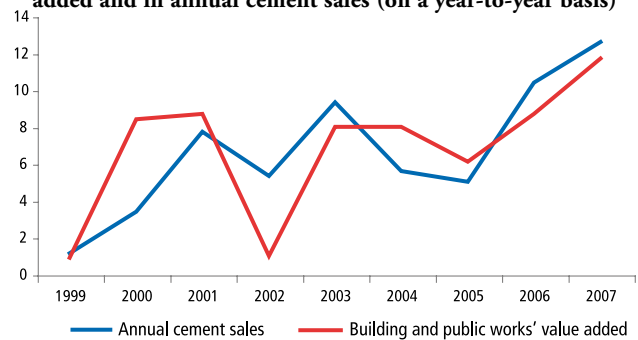
After a 1% contraction in the first half year, the value added of the «hotel and restaurant» branch is expected to see a rebound of 0.4% in the third quarter. This weak performance would be primarily attributable to the continuous drop registered since the beginning of the year in overnight stays in listed hotels. In spite of the increase reported in the general inflow of tourists, estimated at 9% as at the end of July, the main destinations indeed see a fall in overnight stays of tourists from France (-9%), England (-21%) and Germany (-11%). This trend is thought to be linked to growth slowdown in the Eurozone and the United Kingdom, the main generating countries. Similarly, room occupancy rate lost 4 basis points in one year, falling to 46%.

With regard to the transportation sector, its value added is expected to be up by 5.7% in the third quarter, after a 6.1% rise in the first half year, thanks to the growth of air traffic. In fact, the number of international passengers transiting through Morocco's airports was up by 13%, reaching a total of 5.2 million passengers.

In turn, the post and telecommunications sector, the value added of which grew by 11% in the first half year, maintained the same growth pace in the third quarter. The sustained strength of mobile telephony, fixed telephony and internet markets, whose number of subscribers grew in the first half year by 21%, 54% and 36%, respectively, confirms this trend. The rate of penetration of cell phones came to 69.4% and 8.9%, respectively.

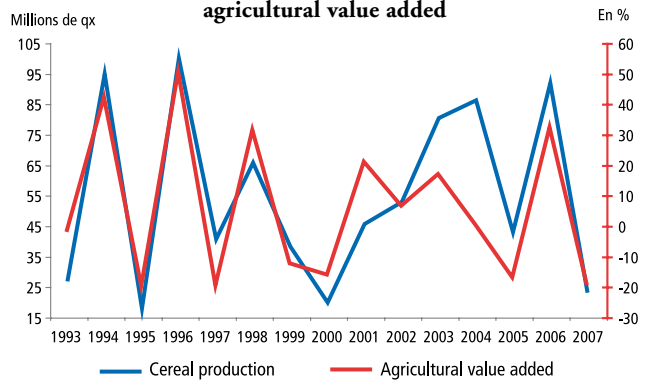
Overall, economic growth is expected to reach 6.7% in the third quarter of 2008, in connection with the improvement in agricultural activities, the positive orientation of non-agricultural activities and the strengthening of consumption and investment. At the end of 2008, growth rate is expected to hover around 6.5%.

Chart 1.2: Change in building and public works' value added and in annual cement sales (on a year-to-year basis)



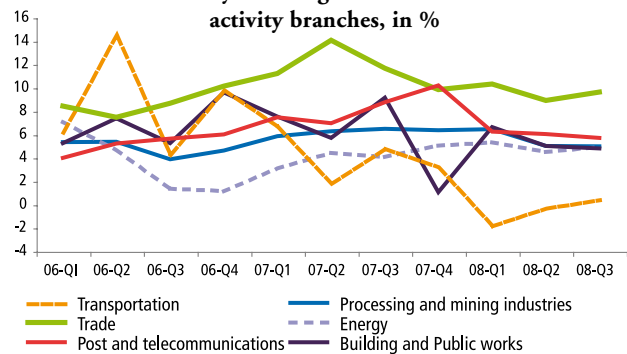
Source : HCP

Chart 1.3: Annual change in cereal production and agricultural value added



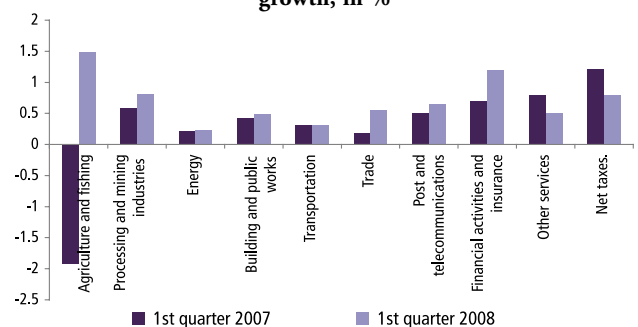
Sources: Ministry of Agriculture and of Marine Fisheries, HCP

Chart 1.4: Year-to-year change in the value added of some activity branches, in %



Sources: HCP, BAM forecasts

Chart 1.5: Contribution of activity branches to overall growth, in %



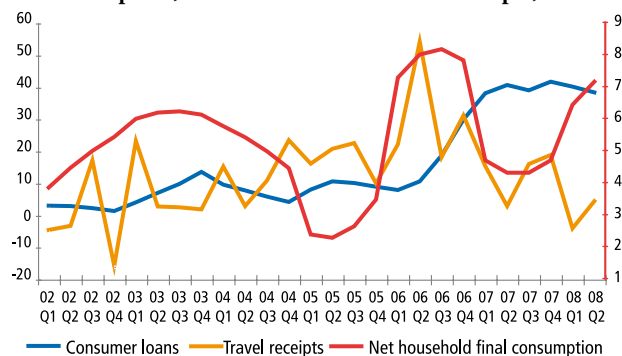
Sources: HCP, BAM estimates

1.2 Consumption

In a context characterized by slowdown in world growth and in particular of our principal economic partner, consumption remains one of the main pillars of domestic growth. Final domestic consumption is expected to increase further in 2008, fuelled by the strengthening of household and general government consumption. Household consumption has been boosted by an increase in rural households' incomes stimulated by the rebound of agricultural activities, the rise by 3.2 basis points in the share of remunerated jobs and the 5.2% increase at the end of July of remittances by Moroccans living abroad. The latter amounted to nearly 30.8 billion dirhams, up by 33.7% compared to the average receipts of the first seven months of 2003-2007. Further, household consumption should benefit from the wage readjustment introduced in July as part of the social dialogue that took place during the first months of the year. The strength of household consumption seems to have strengthened, at the end of July, by the 11.6% increase in the imports of finished consumer products thanks to the 25.7% rise in private car purchases and the 40.4% rise in food products' imports, in particular wheat, corn and butter, as well as the 36.4% increase in consumer loans whose outstanding amount stood at nearly 23.4 billion dirhams. The sharp growth in subsidization expenditure, the level of which reached 18.9 billion dirhams at the end of July, should contribute to preserving households' purchasing power. In fact, it would partially mitigate the impact of the 1 dirham increase in the pump price of "diesel 350", "premium gasoline" and "unleaded gasoline", which came into force last July. In addition, travel receipts, amounting to 31.7 billion dirhams at the end of July, have increased by only 1.8% in one year, thus indicating the substantial contraction in the growth pace of non-resident household final consumption. General government consumption has registered at the end of July a 5.9% increase in operating expenditure, amounting to nearly 62 billion dirhams. This expenditure was attributable to the 5.9% rise in both staff expenses and other expenses of goods and services.

Altogether, further to the revision of BAM macroeconomic framework, final domestic

Chart 1.6: Year-to-year quarterly change in household final consumption, consumer loans and travel receipts, in %



Sources: HCP, Foreign Exchange Office and estimates of BAM

consumption is expected to move ahead by 9.4%, under the effect of a 10.3% increase in final household consumption and a 6.5% rise in general government consumption.

1.3 Investment

The indicators available at the end of July 2008 suggest a continued strength of investment for the remainder of the year. According to the most recent forecasts, the gross fixed capital formation is projected to increase by 15.4%. This investment is thought to have benefited from an increase in value by 23.3% of finished capital equipment imports and 27.8% of equipment loans.

Returns from foreign private investments and loans, though down by 12.3% over one year, showed a 22.9% growth in comparison with average proceeds from January to July of the years 2003-2007. In this total, returns from foreign direct investments, representing 81.6%, fell by 11.6% reaching 16.7 billion dirhams against 18.9 billion one year earlier.

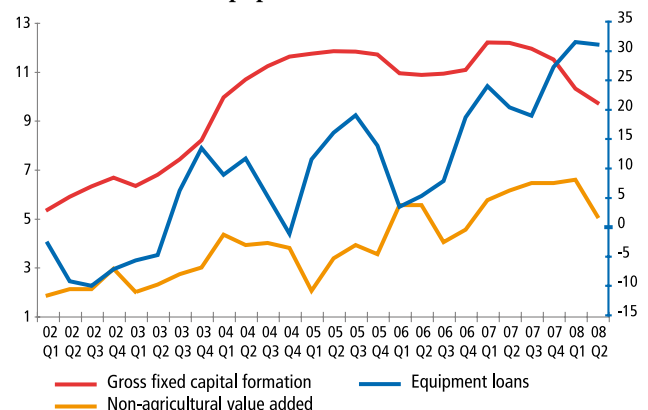
Investment in the real estate sector remains strong, taking advantage of the strength of demand for housing. Over the first seven months of the year, real estate loans were up by 33.7%, thus confirming this positive trend.

The forecasts of corporate managers, based on the conclusions of BAM business survey in the industry for July 2008, suggest an improvement in business climate, marked by the issuance of 37,852 incorporation certificates, up by 6% at the end of July 2008. Altogether, these intentions to create enterprises were aimed at the sectors of services, trade and building and public works sectors, by 52%, 23% and 13%, respectively.

In addition, out of a total of 59 projects submitted, the investment commission approved, by the end of July 2008, 39 projects representing a global amount of 36.5 billion dirhams, which would possibly lead to the creation of 12,890 jobs.

Moreover, Treasury capital expenditure at the end of 2008 amounted to nearly 24.6 billion dirhams, that is an increase of 52.6% compared to the same

Chart 1.7 : Year-to-year quarterly growth of gross fixed capital formation, non-agricultural value added, and equipment loans, in %



Sources: HCP, BAM estimates

period of 2007.

1.4 Foreign trade

At the end of the first seven months of 2008, trade balance showed a deficit up by 31.2% on a year-to-year basis as opposed to 23.6% in the previous year. This degradation is attributable to the 29.9% rise in imports (+42.5 billion dirhams), a pace higher than the 28.7% increase in exports (+20.9 billion dirhams), against respective rises of 16.2% and 9.9% at the end of the same period in 2007. Also, the coverage rate saw a slight deterioration, slipping in one year from 51.3% to 50.8%.

The increase in exports is chiefly attributable to the expansion of phosphates and derivatives' sales, which increased more than twofold in terms of value. Excluding phosphates, exports moved ahead by only 3.2%, basically due to increased sale of fishing products, electrical wires and cables and citrus fruit. Marked falls were registered in the exports of ready-made garments, hosiery items and electronic components, particularly under the effect of the slowdown in foreign demand for these items from our main trading partner, in connection with the deceleration of economic growth in this area.

At the same time, the expansion of imports is basically attributable to the rise in the purchases of energy products and capital goods. Indeed, the energy bill increased under the effect of the 54.3% rise in crude oil imports due to skyrocketing prices. Imports of capital goods and semi-finished products registered substantial rises, reflecting the strength of public and private demand. Similarly, imports of crude products were also on the rise due to growing purchases of sulfur and crude vegetable oil. On the other hand, food bill showed a considerable rise, mainly resulting from wheat and corn imports.

The latest forecasts established by OECD as well as by most international organizations show a drop in Eurozone economic growth rates during the second six months of 2008. This is expected to entail an even greater fallback in Moroccan exports, excluding phosphates and derivatives. As for imports, they would continue to grow in connection with rising commodity prices that, according to the same forecasts, would remain at high but volatile levels.

Table 1.3: Trade balance growth between January and July (year-to-year)

(in millions of Dhs)	J-J	J-J	Change	
	2007	2008	Amount	%
Total exports	72 900	93 799	+20 899	+28.7
Phosphate and derivatives' exports	12 077	31 019	+18 942	+156.8
Exports excluding phosphates and derivatives	60 823	62 780	+1 957	+3.2
Ready-made clothes	12 402	11 676	-726	-5.8
Hosiery items	4 705	4 056	-649	-13.8
Citrus fruit	1 883	2 151	+268	+14.3
Total imports	142 122	184 612	+42 490	+29.9
Energy products' imports	26 784	40 999	+14 251	+53.3
Other imports	115 338	143 613	+28 275	+24.5
Wheat	3 214	6 654	+3 440	+107.0
Capital goods	32 655	40 254	+7 599	+23.3
Consumer goods	27 907	31 156	+3 249	+11.6
Trade deficit	-69 222	-90 813	+21 591	+31.2

Source: Foreign Exchange Office

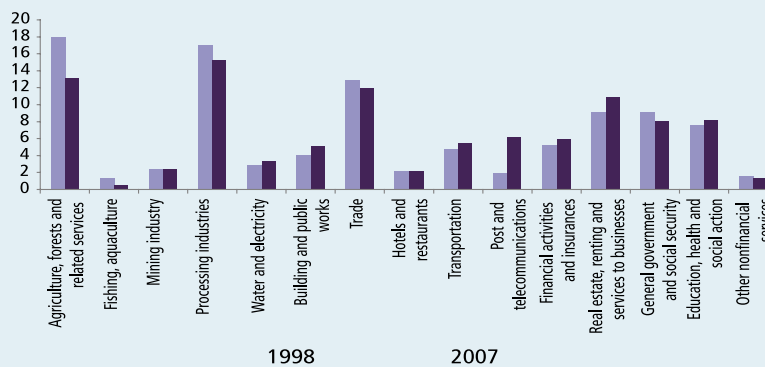
Box 1.1 : Structure of the Moroccan economy according to the national accounting system

Sectoral structure of the value added

Over the period from 1998 to 2007, the sectoral breakdown of the overall value added saw significant changes. The tertiary sector today represents an average share of 57 % of the overall value added, followed by the secondary sector with 26% and the primary sector with 16%. The weight of agricultural value added fell by 5 percentage points, 13% in 2007 against 18% in 1998. The same applies to the fishing and aquaculture sector the share of which was down to 0.5% in 2007 against 1.3% in 1998.

The weight of the secondary sector remained stable from 1998 to 2007. The mechanical, metallurgical and electrical industry has strengthened over the past ten years, as its contribution to the value added increased to 3.4% in 2007 against 2.8% in 1998. On the other hand, the relative share of food, textile and leather as well as chemical and para-chemical industries has declined over the same period. The mining industry kept its share unchanged at 2.4%. The share of the building and public works sector value added has increased from 4.1% in 1998 to 5.1% in 2007.

Chart B 1.1: Value added sectoral breakdown in %



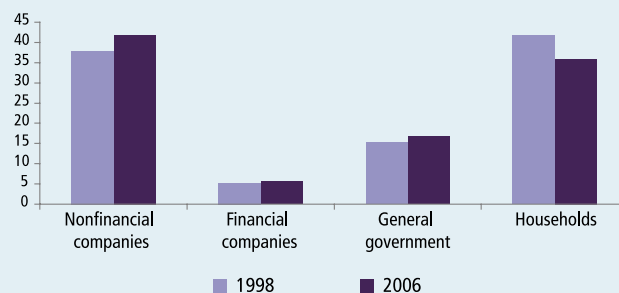
Source: HCP

The tertiary sector has strengthened, reaching approximately 60% of the overall value added in 2007, while it was of 54% in 1998. It was driven by the “post and telecommunications” branch, whose contribution has sharply risen from 1.9% in 1998 to 6.3% in 2007, further to the strong growth in ICT and the significant rise in the use of telephony (fixed and mobile) and of internet.

As far as services are concerned, the shares of “trade” and “general government and social security” has dropped during the period, moving from 12.9% and 9.2% in 1998 to 12% and 8.1%, respectively. The weight of the branches of “transportation” and “financial activities and insurance” has risen slightly while that of the “hotels and restaurants” branch remained almost table at about 2.1% of the overall value added.

Chart B 1.2: Value added structure per institutional sectors, in %

With regard to the distribution of the overall value added per institutional sector, the contribution of nonfinancial companies and households amounts on average to 40% and 38%, respectively, over the period from 1998 to 2006, which indicates the importance of the informal sector in Morocco’s economic structure. The latter saw its share decline to the advantage of the formal sector.



Source: HCP

The contribution of general government has increased, reaching 17% in 2006 against 15% in 1998. The share of financial companies grew by only one percentage point, reaching 6% in 2006.

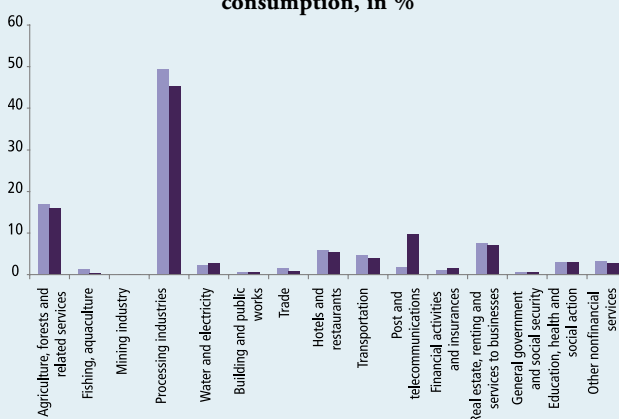
Consumption

Household final consumption on average represents 58.6% of the gross domestic product. This share has slightly dropped between 1998 and 2007, falling from 61% to 58.4%. Conversely, the weight of general government final consumption has gradually increased from 16.7% in 1998 to 18.2% in 2007.

The share of food industry products' consumption fell by 5 percentage points, thus representing 23% of household final consumption in 2007 against 28% in 1998. The other industrial products are characterized by an almost stable structure, except for the mechanical, metallurgical and electrical industry the share of which grew from 3.5% to 8.3%. Altogether, the industrial sector represents approximately 50% of total household final consumption expenditure.

The share of the tertiary sector in household expenditure has substantially increased, constituting 36% in 2007 against 29.3% in 1998. This upward trend observed throughout the period is primarily explainable by the importance attached to services in recent years. Activities of the "post and telecommunications" branch have seen a very noticeable technical progress, notably under the impetus of digital technology, competition and market liberalization. Households have clearly increased consumption of ICT-related goods and services, with a share of 9.7% in 2007 compared to only 1.8% in 1998.

Chart B 1.3: Sectoral breakdown of household final consumption, in %

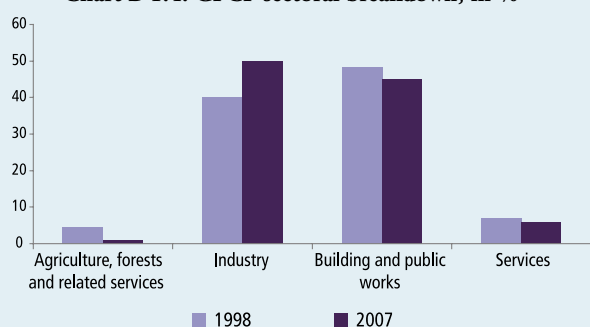


Source: HCP

Investment

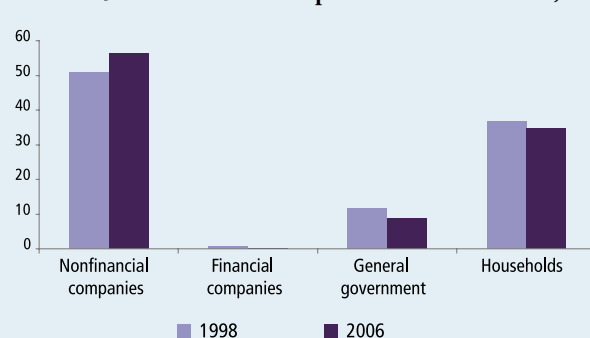
The greater share of investments was directed toward industry and building and public works, with an average respective share of 46% and 47% over the entire period. Indeed, investment in the industrial sector has increased over the past ten years, standing in 2007 at 50% of the overall GFCF against 40% in 1998. On the contrary, services and agriculture sectors on average represented only 6% and 2% in GFCF in the same period, declining from 7% and 4% in 1998 to 6% and 1% in 2007.

Chart B 1.4: GFCF sectoral breakdown, in %



Source: HCP

Chart B 1.5: GFCF breakdown per institutional sectors, in %



Source: HCP

Concerning GFCF structure per institutional sector, nonfinancial companies represent the greatest share of total GFCF. Their weight has in fact increased by 5 percentage points between 1998 and 2006, reaching 56%. Household investment comes in second place, amounting on average to 34% of total GFCF. The share of general government investments has been limited on average to 12% over the same period.

2. PRESSURES ON OUTPUT CAPACITIES AND LABOR MARKET

Given the improvement in the crop year from one year to the next, the overall output gap, according to Bank Al-Maghrib estimates, showed a positive 2.1 Pressures on output capacity value in the second quarter of 2008. The non-agricultural output gap also registered a positive value above that observed in the same period of the previous year, in connection with growth in non-agricultural sectors. Output capacity utilization rate in the industrial sector grew by the end of July 2008, after the drop reported in the previous month. Likewise, the employment situation generally improved in the second quarter of 2008, which led to a drop in unemployment rate at the national level. Net job creation primarily concerned the services and building and public works sectors. As stated in the previous Monetary Policy Report, the increase in the minimum wage in July 2008 and 2009 will have a significant and long-lasting effect on inflation. Altogether, analysis of all these indicators suggests an increase of pressure on prices over the forthcoming quarters.

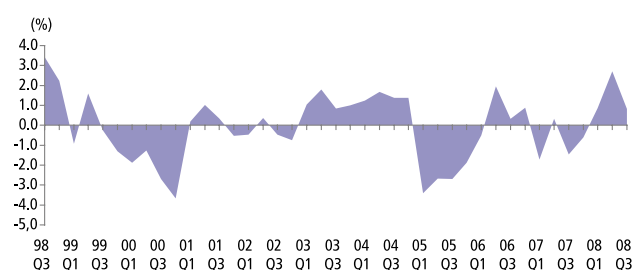
2.1 Pressures on output capacity

Updating of overall output gap measurements on the basis of the latest HCP data (see Table 1.1) has not brought on any significant modification in terms of indications and trends. Hence, after having reported negative figures throughout 2007, the overall output gap has improved in the first quarter 2008 and is expected, according to BAM forecasts (see section 1), to grow further during the second quarter before stabilizing in the following quarter. This trend is largely attributable to the improvement in the crop year from one year to another, as that of 2008 was considered as an average year.

The non-agricultural output gap marked a noticeable acceleration over the first two quarters of 2008 thanks to the strengthening of growth in non-agricultural sectors. However, it is projected to slow down during the third quarter according to BAM forecasts. This slowdown may be explainable by the effects of the economic deceleration in our major European partners that basically impacts demand for Morocco and the tourism sector. Examination of these recent trends suggests mitigation of demand pressure on prices over the forthcoming quarters.

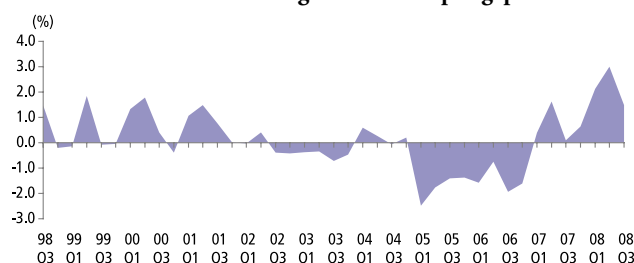
At the same time, the results of the monthly BAM survey in the industry show growth in output capacity utilization rate by one percentage point, standing at approximately 72% in July 2008. This upward trend was observed in all sectors, with the exception of the mechanical and metallurgical industries.

Chart 2.1: Overall output gap



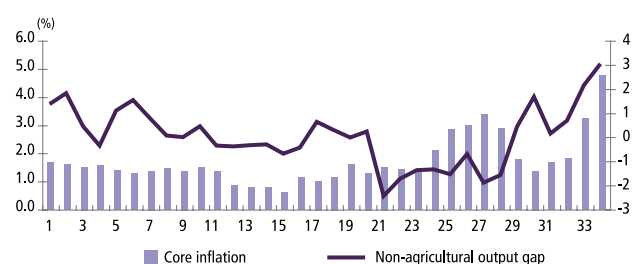
Sources: HCP, BAM estimates

Chart 2.2: Non-agricultural output gap



Sources: HCP, BAM estimates

Chart 2.3: Lagged non-agricultural output gap and core inflation on a year-to-year basis



Sources: HCP, BAM estimates

Apparent labor productivity¹ in non-agricultural activities continued on the upward trend observed since the fourth quarter of 2006. This increase is attributable to the rise in urban employment that was less rapid than that of non-agricultural GDP, estimated by BAM for the second quarter of 2008.

The results of the survey also reveal that the costs of commodities, other than energy, remain the major source of increase in unit production costs in the second quarter of 2008, with a balance of positive opinion of 77%, followed by energy costs, financial costs, and payroll costs.

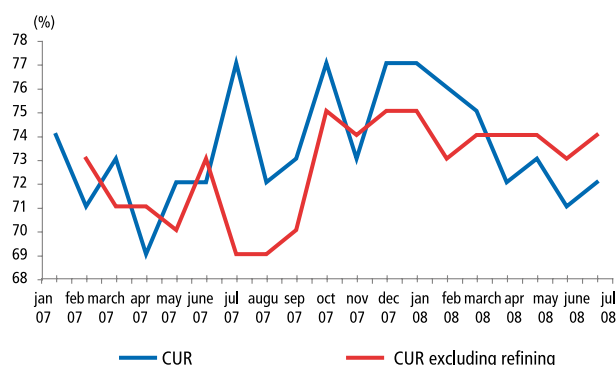
2.2 Pressures on labor market

The labor force saw quasi stagnation in the second quarter of 2008, that is nearly 11.3 million persons. This result covers a rise in the labor force by 1.5% in urban areas and a drop by 1.7% in rural areas. Therefore, activity rate diminished by nearly 1.1 point, falling from 52.1% in the second quarter of 2007 to 51% in the same period of 2008.

The job market continued to improve in the quarter under review, as reflected by the increase in the occupied labor force since the third quarter of 2007, thus keeping pace with growth in GDP. Therefore, the rate of unemployment declined in the second quarter of 2008, falling from 9.6% to 9.1% from one quarter to the next and from 9.4% to 9.1% compared to the same quarter of the previous year.

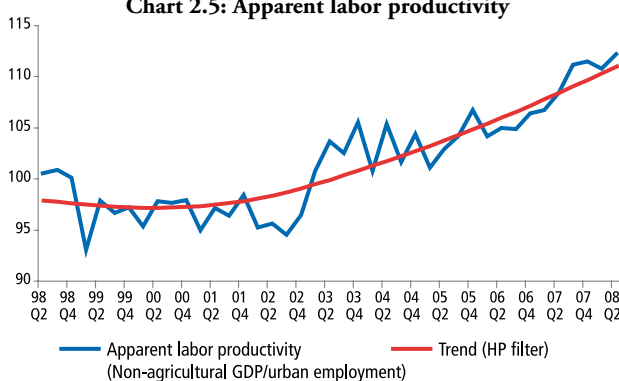
The overall rate of employment has yet declined, standing at 46.4% against 47.2% one year earlier, as a result of growth in the number of jobs which was slightly below that of the population aged 15 years and over. On the other hand, urban employment rate has increased at the same pace as in the previous year which remains faster than that of total GDP.

Chart 2.4 : Industrial output capacity utilization rate



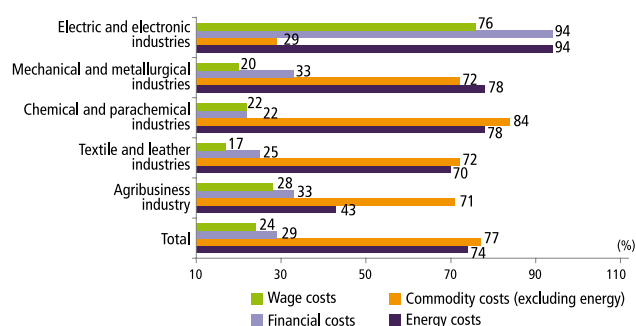
Source: BAM's monthly business survey

Chart 2.5: Apparent labor productivity



Source: HCP, BAM estimates

Chart 2.6: Change in unit production cost components (balances of opinion in % in Q2 of 2008)



Source: BAM's monthly business survey

¹ The apparent labor productivity is measured by the ratio between output and employed labor force. This indicator must be interpreted with precaution, as it does not take into account the efficiency with which labor force is used in production.

In connection with the strengthening of growth in non-agricultural activities, the increase in the number of jobs primarily concerned urban areas, where unemployment rate reached 14% against 15% one year earlier, while in rural areas this rate rose from 3.4% to 3.9%. The rise in the level of employment is supported by a substantial increase in remunerated employment for which 325,000 jobs were created in the second quarter of 2008 against a net loss of 305,000 non-remunerated jobs.

At the sectoral level, job creation basically concerned the services sector with 152,000 new jobs (+4.2%) and the building and public works sector with 80,000 jobs, up by 9.7%.

At the same time, the conclusions of BAM business survey of the second quarter of 2008 confirm the increase in the employment rate from one quarter to the next. Except for the textile and leather industries that registered a drop in labor force due to exports' decline, the other sectors saw an increase in labor force. The expectations of the interviewed industrialists about the job prospects over the next three months remain globally indicative of an increase in employed labor force.

With regard to wages, the quarterly average wage index, calculated by the HCP on the basis of CNSS data and in reference to the average wage of the year 2004, registered in the first quarter of 2008 a rise of 7.5% on a year-to-year basis against a drop of 1.2% compared to the previous quarter. In real terms, this index grew by 5% over the same period. In the second quarter of 2008, the results of the business survey reveal a rise in the wage level with a balance of opinion slightly below the previous quarter.

Table 2.1 : Activity and unemployment quarterly indicators per place of residence (year-to-year ⁽¹⁾)

In millions	Q2 - 2007			Q2 - 2008		
	Urban	Rural	Total	Urban	Rural	Total
Labor force and employment						
Workforce ⁽²⁾	5.79	5.55	11.34	5.88	5.45	11.34
Labor force participation rate (%)	45.4	61.4	52.1	45	59.7	51
Occupied labor force	4.92	5.36	10.28	5.06	5.24	10.3
Employment rate (%) ⁽³⁾	38.6	59.3	47.2	38.7	57.4	46.4
Unemployment						
Unemployed labor force	0.86	0.19	1.06	0.82	0.21	1.03
Unemployment rate (in %)	15	3.4	9.4	14	3.9	9.1
By degree						
. Graduates	8.8	2.4	4.7	8.4	2.5	4.7
. Non-graduates	20.5	9.8	18.3	19	11.4	17.3

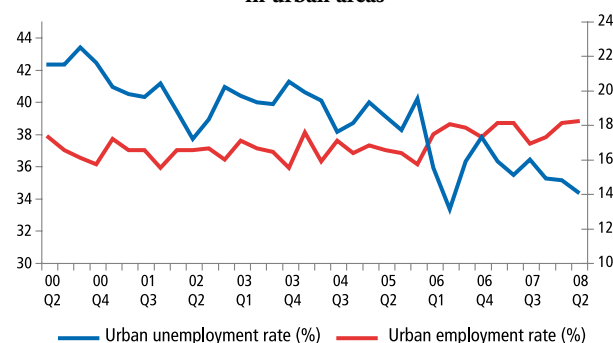
(1) Data adjusted according to the new population forecasts

(2) Population aged 15 years and over (in millions of persons)

(3) Occupied labor force/ total population aged 15 years and over.

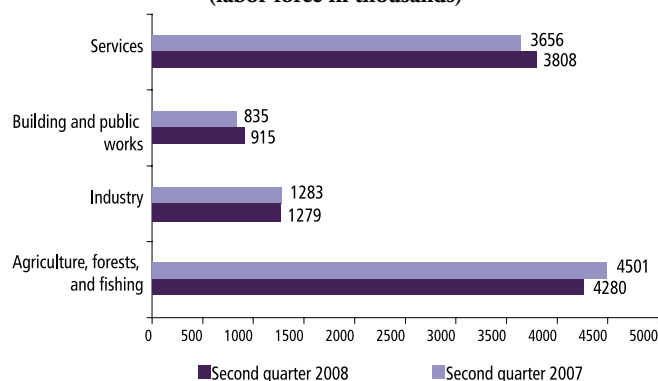
Source: HCP

Chart 2.7: Employment and unemployment rate in urban areas



Source: HCP

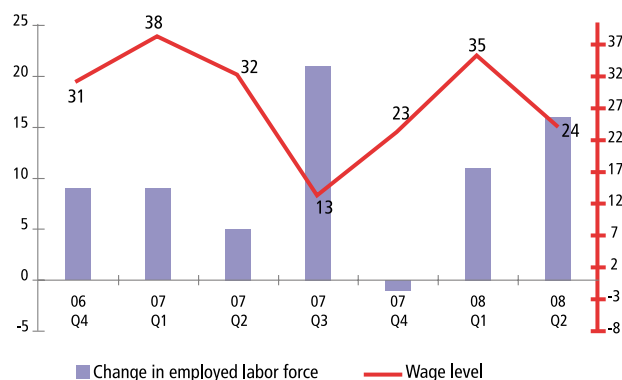
Chart 2.8: Net job creation per sector of activity (labor force in thousands)



Source: HCP

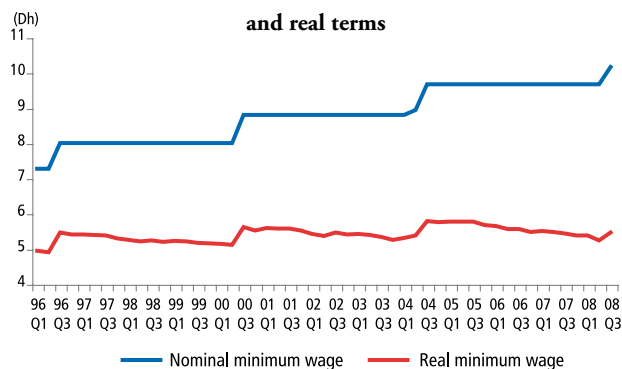
Furthermore, the first phase of readjustment of minimum wage and public sector wages, following social dialogue between the government and trade unions, has legally come into force in July 2008. Thus, the minimum hourly wage of workers and employees in industry, trade and liberal professions increased by 5% in the third quarter of 2008 rising from 9.66 to 10.14 dirhams. It also showed slight rise in real terms¹, going from 5.22 to 5.44 dirhams.

Chart 2.9: Change in wage level and in employed labor force in the industry (balances of opinion)



Source: BAM monthly Business Survey

Chart 2.10: Quarterly minimum wage in nominal and real terms



Source: Ministry of Employment

¹ Calculated on the basis of BAM CLI forecasts for the third quarter of 2008.

3. IMPORT PRICES

In the main OECD countries and many emerging countries inflation continues to maintain a pace incompatible with the price stability objective that central banks are required to achieve. The recent international context has also been characterized by marked slowdown in economic activity in OECD countries and the Eurozone, as well as by the uncertainties now beginning to weigh on the amplitude of the impact of the said slowdown on emerging countries. Since the last Monetary Policy Report, the pace of international price rise of the main commodities has slowed down and oil price has been on a downtrend. The inflationary pressures caused by import prices yet remain at very high levels and these trends still need to be confirmed. The import price index excluding energy products was up again in the second quarter at 40%, after having registered a 30% year-to-year increase in the first quarter. However, in terms of monthly variation, it has been almost stable since last April. Altogether, internal fuel prices, particularly of diesel, remain largely supported by the Subsidization Fund, in spite of the rise in the domestic price of some types of fuel. On the whole, these factors should continue to exert significant pressure on inflation over forthcoming quarters. However, they would be somewhat alleviated by confirmation of abatement on the commodity markets that would eventually spread gradually to the development of our import prices.

3.1 World inflation

The latest data available show a slowdown in headline inflation, particularly in the Eurozone where EUROSTAT estimation stood at 3.8% for August against 4% one month earlier. This decline in inflation is the first one noted since last April.

In France, Germany and Spain, headline inflation slowed down in August to 3.5%, 3.3% and 4.9% against 4%, 3.5% and 5.3% in the previous month. On the other hand, in Italy it increased to 4.2% against 4% one month earlier (Table 3.1).

This slowdown in headline inflation is the result of a decline in international prices of oil and other commodities, as well as of a downward revision in world economic growth prospects, particularly in the Eurozone. Similarly, doubts are beginning to arise regarding the ability of emerging countries, which to date have sustained world growth, to resist economic slowdown in OECD countries. Also, the mounting phenomenon of productive capacities underemployment in the United States and the Eurozone now seems to produce the sought disinflationary effects.

However, compared to the previous year, headline inflation remains at high levels. Indeed, it rose from 1.7% in the Eurozone in August 2007 to 3.8% one year after. Likewise, in the United States, it amounted to 5.4% as opposed to 2% in the same month of 2007. This trend results from the rise in world prices of energy and agricultural commodities.

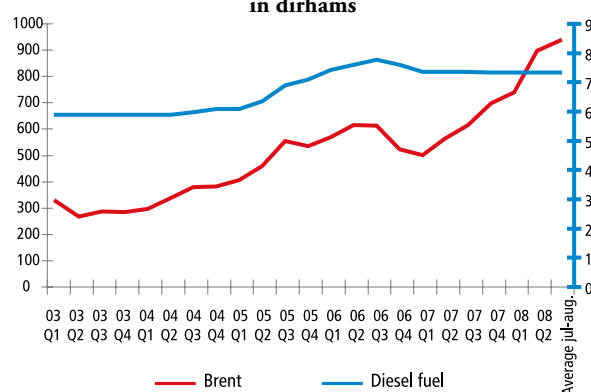
Table 3.1: Recent evolution of world inflation
(year-to-year)

	2007	2008	2008	Forecasts	
	August	July	August	2008	2009
United States	2.0	5.6	5.4	4.2	2.0
Eurozone*	1.7	4.0	3.8	3.6	2.5
Germany	1.9	3.5	3.3	2.9	2.3
France	1.2	4.0	3.5	3.5	1.9
Spain	2.1	5.3	4.9	4.7	3.1
Italy	1.6	4.0	4.2	3.8	2.8

(*) Harmonized indices

Sources: IMF, Eurostat

Chart 3.1: World oil price and pump price in Morocco, in dirhams



Sources: IMF and Ministry of Energy and Mining

According to most analysts, if current trends on the commodity markets persist, headline inflation should ease over the upcoming months provided wage hikes are kept in check.

3.2 Oil prices

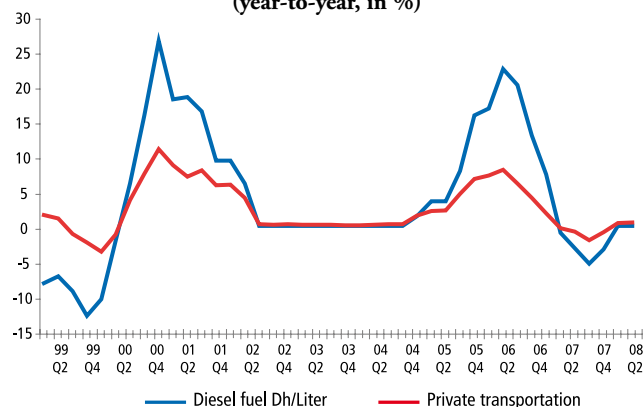
In August the Brent barrel price stood at 115 dollars against 133 dollars in the previous month, down by 13.5%. This trend is essentially linked to lower world demand in connection with the downward revision of the economic growth outlook particularly in the Eurozone and the rise in OPEC quotas. Reversal of the dollar's downward slide also contributed to this new trend. Nevertheless, at the end of the first eight months of 2008, the average price of crude oil amounted to 113 dollars per barrel, up by 55% compared to the average of 2007.

In Morocco, as of July 1st, 2008 prices at the pump were readjusted upwards for certain types of fuel. Starting that date, the prices of gasoline and diesel 350 were up by 1 dirham each, reaching 11.25 and 10.13 dh/liter, respectively, which represents rises by 10% and 11%. The price of industrial fuel rose from 500 dirhams per ton, or 17%. In spite of these readjustments, domestic prices remain mitigated through the intervention of the subsidization fund.

According to the most recent IMF forecasts, average oil price in 2008 was revised upwards at 116.50 dollars instead of 95.5 dollars a barrel estimated last April. Similarly, according to the consensus among central banks, in 2008 the average oil price is expected to reach 115 dollars per barrel. Also, OECD projections suggest a barrel's price at 120 dollars. On the futures market, the oil price is expected on average to reach 120.2 dollars per barrel in 2009.

All these predictions converge on stability in prices at their current level, at approximately 115 dollars per barrel. However, prices are expected to remain volatile, around this level, due to uncertainties weighing on supply in connection with geopolitical tensions.

Chart 3.2: Fuel pump price and transportation price (year-to-year, in %)



Sources : HCP and Ministry of Energy and Mining

Table 3.2: Oil price forecasts (Brent in US \$)

	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Year 2009
Futures	122.3	117.5	119.5	120.2	120.2

Source : Bloomberg

Table 3.3 : Domestic selling price of oil products

Products (Dh/Liter)	Jan. 2007	June 2007	Dec. 2007	Jan. 2008	April 2008	July 2008	August 2008
Premium gasoline	10.25	10.25	10.25	10.25	10.25	11.25	11.25
Diesel fuel	7.22	7.22	7.22	7.22	7.22	7.22	7.22
Diesel 350	9.13	9.13	9.13	9.13	9.13	10.13	10.13
Industrial fuel (Dh/Ton)	2874	2874	2874	2874	2874	3374	3374

Source: Ministry of Energy and Mining

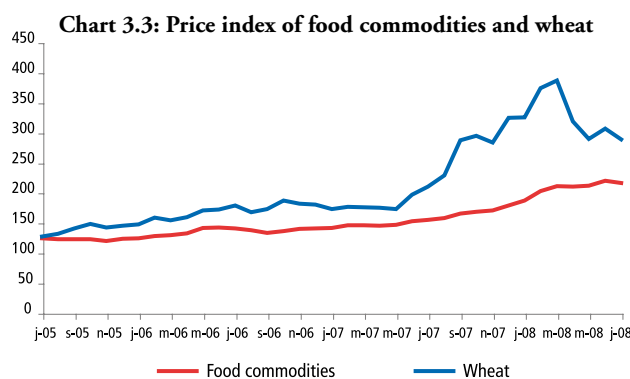
3.3 Commodity prices

In a context of slowdown in global growth, the prices of agricultural commodities and of metals stabilized on the whole in July 2008, but remained at high levels compared to the previous year.

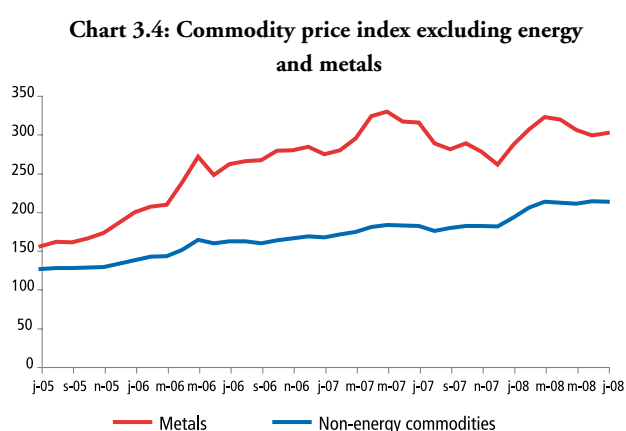
During the first seven months of 2008, commodity prices generally maintained their upward trend on the world market. In fact, IMF commodity price index, excluding energy, on average increased by 18% on a year-to-year basis. This trend concerned food products, the index of which on average grew by 41.7% year to year. Wheat price indeed moved ahead on average by 87.7% in the first half of 2008 in connection with the sustained increase in demand primarily from emerging countries. In July, it registered a substantial drop further to the announcement of good harvest thanks to favorable weather conditions and the enlargement of crop areas in the major producer countries, principally the United States. On the average of the first seven months of 2008, wheat price yet remained 45.7% higher than the level reported in 2007, that of corn 48.6% and barley 33.9%.

Metals price index showed a 0.3% drop on average over the first seven months of 2008 on a year-to-year basis, basically attributable to the decline in the prices of zinc and lead that saw respective falls of 31.8% and 2.8%, compared to their average price in 2007. This trend is explainable by the mounting fears linked to the impact of world economy slowdown on the demand for metals, as well as by the rise in stockpiles and the improvement in the supply outlook. Conversely, copper price remained steady, registering a 14.7% rise under the effect of the drop in world output and stocks.

According to IMF predictions, food commodity prices will hold steady at high levels and remain volatile, primarily under the effect of the continuous rise in biofuels output and demand from emerging countries. However, cereal prices could go down further to good harvests in the principal producer countries. Metal prices, according to recent trends on the futures market, should gradually fall over the upcoming quarters.



Source: IMF

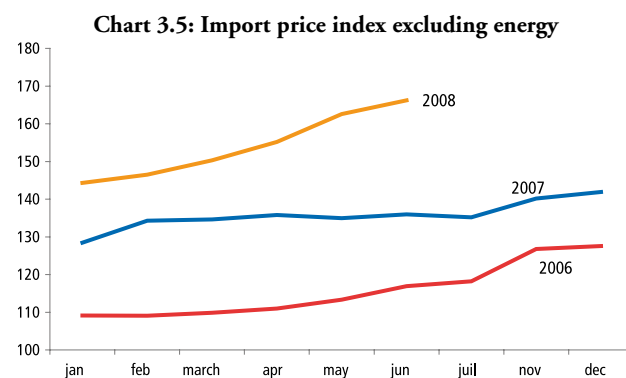


Source: IMF

Table 3.4 : Change in wheat futures and forecasts

Wheat (US\$/bushel)	Q3 2008	Q4 2008	Q1 2009	Year 2009
Futures	817.0	894.8	917.5	928.7
Forecasts	850.0	852.5	940.3	817.0

Source : Bloomberg



Sources: Foreign Exchange Office, BAM estimates

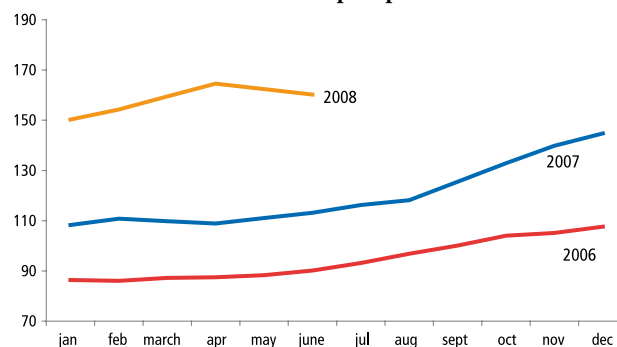
3.4 Import price indexes

Import price indexes, calculated by Bank Al Maghrib, reflect somewhat belatedly the trends described in the previous section. After having registered a year-to-year growth of 30% in the first quarter, the import price index excluding energy (IPI) once again was up in the second quarter at 40%. However, in terms of monthly growth, the index has been virtually stable at this level since April 2008. The lull on commodity markets will gradually spread to Morocco's import prices. This general trend conceals certain disparities depending on the type of product imported.

Growth in food products IPI slightly slowed to 42% in the second quarter after having registered a record at 50% in the first quarter. This slowdown is the result of the drop or deceleration in the price rise pace of most products, with the exception of corn and sugar. Indeed, corn import price registered a record high of 49%. This trend comes in the wake of global increase in livestock feed prices, which led to a rise in the prices of meat and milk. Likewise, sugar price rose by 7% registering for the first time since January 2007 a positive trend. Price projections for this product are upwards, given the expected drop in world exports and the rise in ethanol production, particularly in Brazil. Milk import prices in the second quarter registered a drop of about 15% while on world markets a reversal of trend has been observed since last March, which suggests that milk IPI in the third quarter will certainly reflect this rise.

The growth in industrial commodities' IPI stabilized, but at a very high pace not reflexive of world market trends. This is the result of the special structure of this type of imports, wherein sulfur accounts for approximately 50%. Given that world prices of this ore are very high, fuelled by a very strong global demand for fertilizers¹, the overall index is very strongly oriented upwards. Iron, which is more likely to impact businesses' production costs, is not concerned by the present lull in commodity markets. Indeed, iron prices are fixed at the beginning of each year via negotiations between the main producers and consumers. In 2008 these prices were revised upwards by 65%. Nevertheless, the data available still do not show

Chart 3.6: Food import price index



Sources: Foreign Exchange Office, BAM estimates

¹ Sulfur is a major input in the manufacturing process of phosphate fertilizers.

Box 3.1: Chinese exports, import prices and inflation

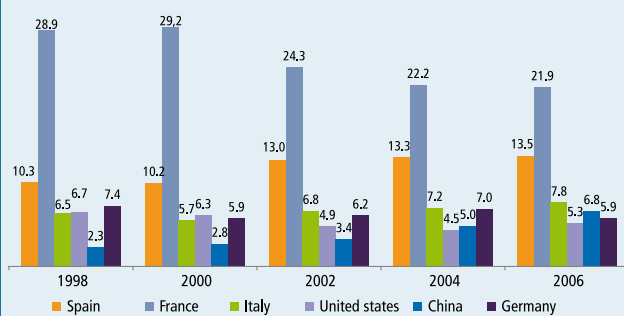
Since January 2007, China has undergone inflationary pressures. Indeed, year-to-year headline inflation rate stood at 4.8% in 2007 and reached 6.3% in July 2008 while between 1997 and 2006 it remained under the 2% mark. This acceleration of inflation is often ascribed to higher food prices. However, the rising labor cost is becoming a subject of concern: the average urban real wage in China rose by 18.7% in 2007 and on average by 14% between 2001 and 2006.

These inflationary pressures are coming to the fore while Chinese exports have substantially moved ahead from 5% of world trade in 1999 to 11% in 2006. The weight of China in world trade is close to that of the United States and higher than that of Japan. The structure of its exports has also changed with its share in global exports of high-tech sectors grew from 3.4% in 1999 to 11.7% in 2005. The rise of the share of Chinese imports in world trade was coupled with a drop in the import prices of manufactured goods in several countries.

From the standpoint of monetary policy, the emergence of China on the world trade front had two major implications. On one hand, it corresponded to a positive supply shock making it possible to associate a lower headline inflation rate with a given output gap. On the other hand, by injecting more competition at the price level, Chinese imports exerted pressure on costs and wages beneficial to price stability. Indeed, the said competition, even when only potential, has had important disciplinary effects on world prices.

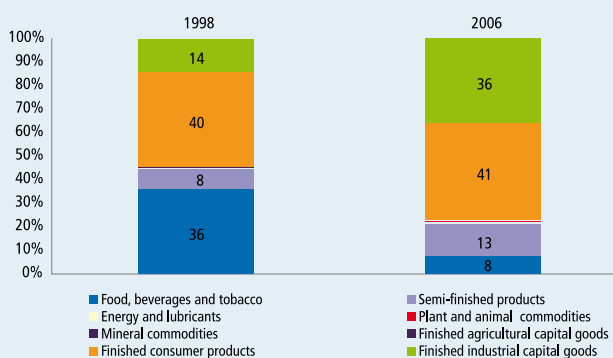
In Morocco, the share of imports from China grew by 150% between 1998 and 2007. The mounting importance of China in Morocco's trade denotes a change in the flow of trade from its traditional suppliers, in particular France, towards the emerging countries, notably China. France's share has thus fallen from 26.3% in 1998 to 17.13% in 2006 (Chart B3.1). Similarly, the structure of imports by remarkable products has seen an important change (Chart B3.2). It rapidly diversified to the benefit of higher value added products. Indeed, the share of food, beverages and tobacco heading has sharply fallen from 36% to 8%, whereas that of finished industrial capital goods increased from 14% in 1998 to 36% in 2006. Likewise, the share of semi-finished products rose from 8% to 13%.

Chart B 3.1: Market shares of Morocco's main suppliers excluding energy



Sources: Foreign Exchange Office, BAM estimates

Chart B 3.2: Structure of Moroccan imports from China



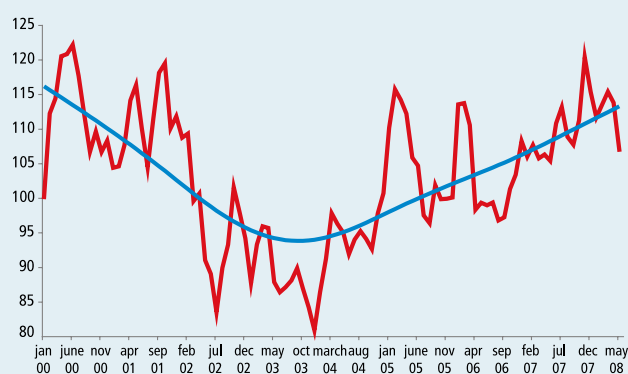
Sources: Foreign Exchange Office, BAM estimates

From an inflationary standpoint, the change in the structure of Moroccan imports from China indicates that alongside first-round effects which spread to increasingly higher levels of value added and are transmitted through the direct impact of the import of final consumption goods, there are also increasing second-round effects which are transmitted either through the impact of the import of finished industrial capital goods on the cost of investment or via the impact of semi-finished products' imports on output costs. Similarly, the change in the flow of trade is likely to cause a drop in import prices, as this implies substituting a supplier charging high prices with another charging lower prices, which constitutes a positive supply shock.

A unitary value index of a sample of Chinese products was calculated for Morocco from January 2000 to June 2008. However, it is noteworthy that the indexes calculated on the basis of unitary values are less reliable than those based on price surveys that do not yet exist in Morocco, because their development constitutes a combination of the joint effects of price variations and product quality.

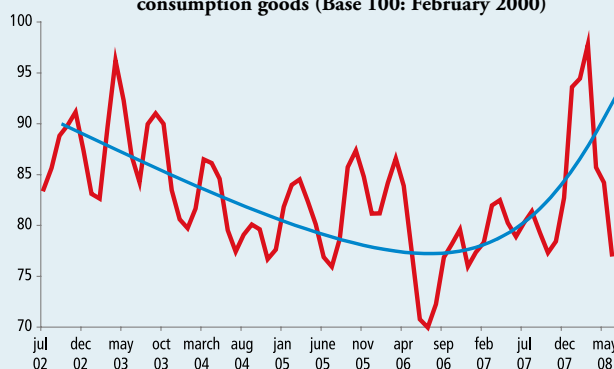
The calculated index clearly showed a downturn to the end of 2003, but as from early 2004 there was a reversal in trend (Chart B3.3). However, this rise is more likely a quality effect rather than a price effect. Indeed, as imports from China of high value added products, and of course at a higher price, are growing the index also goes up. This interpretation is all the more probable as the rise in the index occurred at a date prior to the beginning of inflationary pressures in China. It is thought to be more reflexive of a deflationary effect at a higher level of value added.

Chart B 3.3: Moroccan index of Chinese import prices
(Base 100: February 2000)



Sources: Foreign Exchange Office, BAM estimates

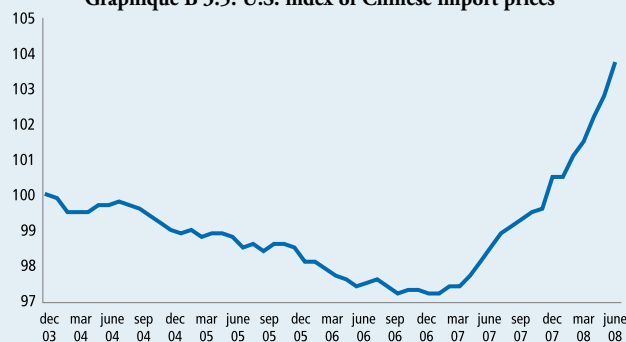
Chart B 3.4: Moroccan index of Chinese import prices of final consumption goods
(Base 100: February 2000)



Sources: Foreign Exchange Office, BAM estimates

To provide an answer to this issue, a unitary value index was calculated for final consumption goods (Chart B4.4). This index also is on the rise and in this case we can assume that the price effect has the edge over the quality effect for two reasons. Firstly, over the survey period the rise in product line concerned more greatly the other product categories, that is to say finished industrial capital goods or semi-finished products. Secondly, the outset of this price rise episode corresponds to the beginning of inflationary pressures in China, in early 2007 with a sharp acceleration at the beginning of 2008. Therefore, in March 2008 the index was 97, hitting a record high since April 2002. On average, it grew by 20% on a year-to-year basis in the first quarter of 2008, while in 2007 it rose by only 2.8% against -4.7% in 2006. The development of the U.S. price index of Chinese imports (Chart B3.5) confirms these trends. Indeed, since May 2007 this index has shown positive growth rates of approximately 3.4% in the first quarter of 2008 and 4.1% in the second quarter.

Graphique B 3.5: U.S. index of Chinese import prices



Source: Bureau of Labor Statistics

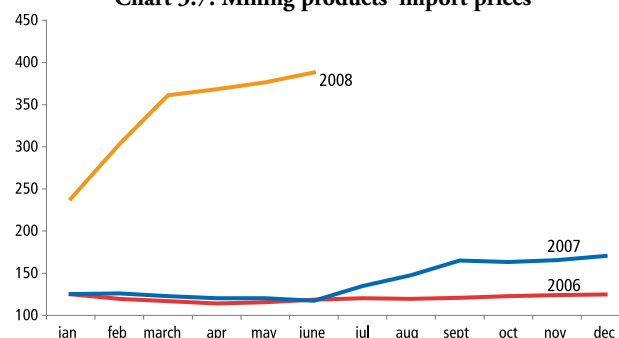
In conclusion, it can be noted that Morocco, like the remainder of the world, can be affected by Chinese inflationary pressures, especially as China may impact world prices not only as a major energy and commodity importer but also through its export prices.

any complete repercussion brought on by this rise. Indeed, for the second quarter, the rise recorded was of only 35%. On the other hand, prices of other mining commodities dropped in the wake of world market. By way of example, import prices of zinc fell by 38%.

Import price index of semi-finished products shows that this category of imports did not cause any particular inflationary pressures in 2007. On the contrary, in 2008 the index seems to see intensification in trend compared to 2007 and 2006. On a year-to-year basis, the index has in fact grown by 9% in the second quarter of 2008 against 5% in the first quarter and 7% in 2007.

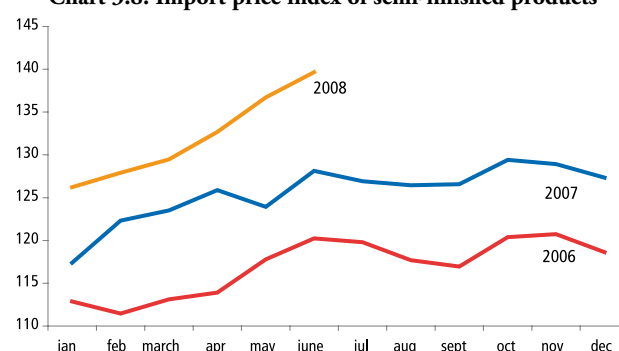
Inflationary pressures caused by import prices are beginning to stabilize, but at levels much higher than those of the previous year. The development prospects of import prices show that they will continue to exert significant pressure on inflation over the forthcoming quarters. This pressure will wane progressively as the lull on commodity markets becomes more noticeable.

Chart 3.7: Mining products' import prices



Sources: Foreign Exchange Office, BAM estimates

Chart 3.8: Import price index of semi-finished products



Sources: Foreign Exchange Office, BAM estimates

4. MONETARY CONDITIONS AND ASSET PRICES

Since publication of the last MPR, the orientation of monetary conditions has seen no significant change and remains marked by the continuation of both the slowdown in monetary growth and the strength of credit, whose growth rate has slightly diminished. M3 growth pace did in fact fall to 12.2% in July, thereby reducing the extent of money surplus. This trend was coupled with a movement of portfolio switching by nonfinancial agents to the benefit of time deposits, whose year-to-year growth reached 27.4% in July 2008, concurrent with the rise in their interest rates. The annual growth rate of paper money eased slightly, settling at 9.5% in July while that of bank money returned to the exceptionally low level of 8%. Liquid investments also seem to have taken advantage of nonfinancial agents' switching of surplus monetary holdings, thereby registering a growth rate of 3.3% on a year-to-year basis after having declined over three quarters. Even though its expansion remains relatively strong, bank credit slightly slowed down in July on a year-to-year basis in connection with the drop in the growth of all loan categories and the contraction of the outstanding amount of non-performing loans. Lending to businesses remains dominant, indicating the sustained contribution of credit to the strengthening of output and investment. However, on the basis of the conclusions of BAM survey among the banking sector, it could see some slowdown over the forthcoming quarters. The data of BAM survey on lending rates show that they were on a downward slide between the first and second quarter of 2008, globally returning to the average level observed since the second quarter of 2007. As for stock market asset prices, they showed a fallback at the end of the second quarter of 2008. This drop continued in July and August while real estate asset prices, according to the information gathered, remained at a high level.

4.1 Monetary conditions

4.1.1 Interest rates

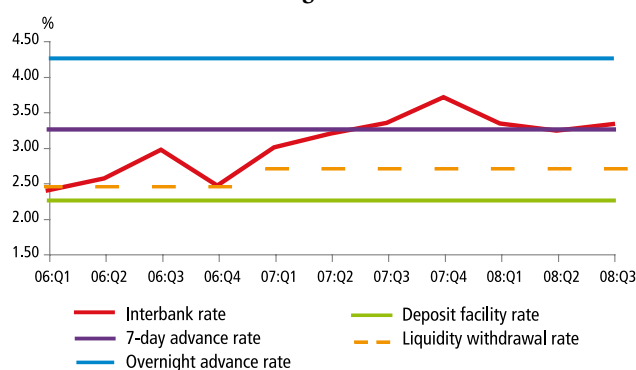
At its meeting of June 17th, 2008 the Board of Bank Al-Maghrib, after examination of the economic, monetary and financial situation, decided to keep the key rate unchanged at 3.25%. Between July and August, the interbank rate reached 3.31%, after having stood on average at 3.21% in the second quarter.

Against this backdrop, rates of 13-week Treasury bills, which was the only maturity issued by auction between July and August, continued their downward trend observed at the end of the last two quarters. On the contrary, yields of medium and long-term bills on the secondary market, which remain the reference in absence of auctions on the primary market, registered a rise from 4 to 39 basis points.

As for borrowing rates, the weighted average rate of 6 and 12-month deposits resumed its upward slide in the second quarter of 2008 and in July, after a slight dip in the first quarter.

With regard to lending rates, the first results of BAM survey among banks for the second quarter of 2008 suggest a downward adjustment¹ of the average weighted rate of bank loans compared to

Chart 4.1: Change in interbank rate*



* Observation of the third quarter of 2008 corresponds to the daily average of the period from July 1st to September 4th 2008.

Table 4.1: Change in short-term TB yield rates on the primary market

	2007				2008		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3*
13 weeks	2.73	3.30	3.29	3.63	3.58	3.41	3.40
26 weeks	2.85	3.34	3.32	3.58	3.59	-	-
52 weeks	2.97	2.88	3.40	3.55	3.62	3.53	-

* Observation of the third quarter of 2008 corresponds to the average of July and August

1 These preliminary results are being confirmed from banks

the previous quarter, after the rise registered in the first quarter. This trend primarily resulted from a decline in rates on cash advances to businesses. Rates on equipment loans registered a rise while those on consumer loans seem to stabilize at a historically low level but above those applied on the other categories.

Chart 4.2 : Change in interest rates' structure per maturity on the Treasury securities market

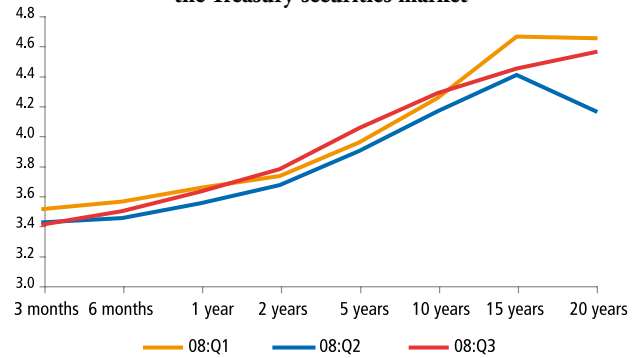


Table 4.2 : Borrowing rates * (time deposits)

	2007				2008		
	Q1	Q2	Q3	Q4	Q1	Q2	July
6 months	3.26	3.52	3.41	3.49	3.37	3.55	3.65
12 months	3.65	3.63	3.69	3.71	3.71	3.82	3.98
Weighted average	3.49	3.58	3.60	3.62	3.56	3.72	3.85

* Quarterly data are simple averages of monthly data.

Box 4.1: Liquidity and implementation of monetary policy

During the second quarter of 2008, banks' liquidity shortage was partially mopped up under the effect the expansive change in Treasury operations and foreign currency transactions. Accordingly, the liquidity deficit fell from an average of 9 billion in Q1 of 2008 to 8.4 billion in Q2 of 2008.

In the second quarter of 2008, Treasury operations gave rise to a liquidity injection of 2 billion dirhams, primarily attributable to the Treasury's debt reduction, whose net reimbursements reached 15.8 billion, as well as to the massive withdrawals by the Treasury's main depositors.

Indeed, Barid Al-Maghrib withdrew 7.5 billion dirhams from Treasury accounts in May and June 2008. Also, Maroc Telecom paid a part of its dividends, equivalent to the portion of shareholders other than the State and Vivendi, from its deposit account at the Treasury, a transaction that led to a liquidity injection of 830 million dirhams.

Operations on foreign assets also contributed to boosting banks' cash holdings for an amount of 4.5 billion dirhams further to selling operations of foreign bank notes reaching 6.4 billion dirhams, partially offset by currency purchases by commercial banks for an amount of 1.9 billion dirhams.

On the other hand, notes and coins in circulation registered a rise of 1.8 billion dirhams, attributable to banknotes withdrawals just before summer vacation.

Chart B 4.1: Change in liquidity position (in millions of dirhams) and in weighted average rate (%) in quarterly average

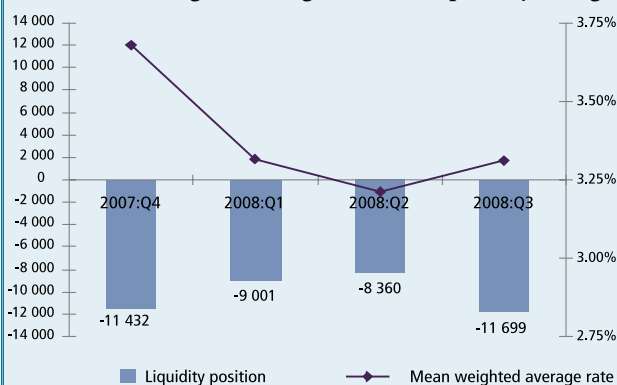
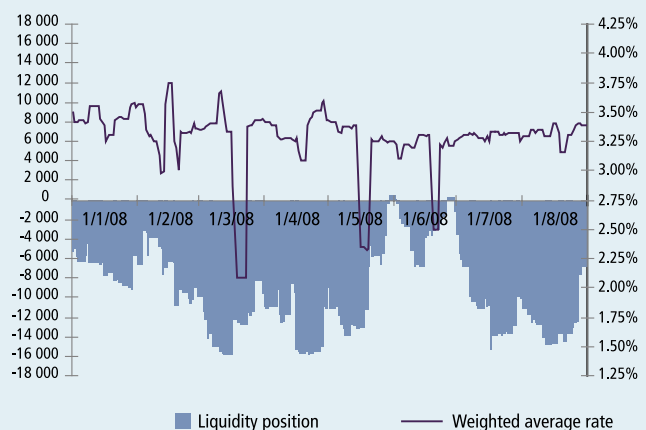


Chart B 4.2: Liquidity position (in millions of dirhams) and weighted average rate of the interbank money market



On the whole, the expansive impact of autonomous factors rose to 4.6 billion dirhams during the second quarter of 2008, thereby contributing to improving liquidity conditions. Through this quarter, minimum required reserves slightly fluctuated, registering an overall decline of only 192 million dirhams.

The expansive trend in autonomous factors was reversed in the third quarter of 2008 due to the rise in demand for bank notes, the delay in tax collection, the speed-up in foreign currency purchases, and the increase in minimum reserve requirements. Consequently, banks' liquidity shortage on average stood at 11.7 billion dirhams in 2008 Q3 against 8.4 billion the previous quarter.

Net withdrawals of paper money totaled 7.8 billion dirhams in summer and net Treasury receipts rose to 1 billion dirhams.

Chart B 4.3: Change in reserve requirements (in millions of dirhams)

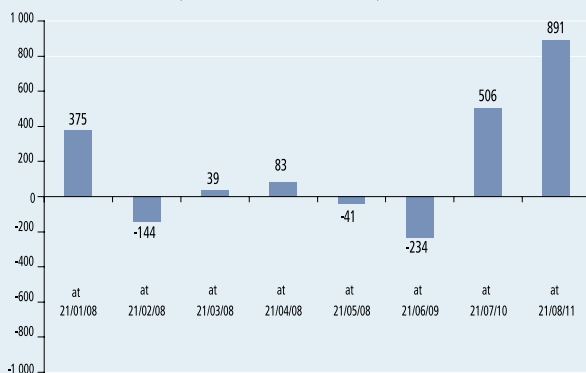
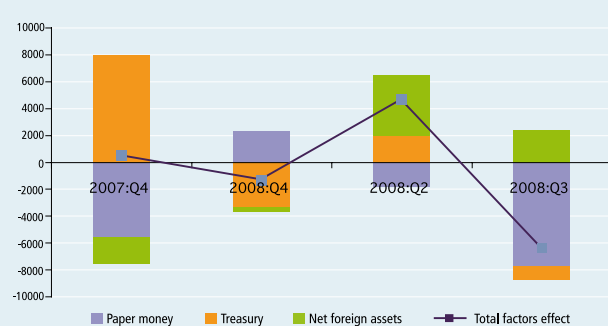


Chart B 4.4: Change in liquidity factors effect (in millions of dirhams)



Foreign currency purchase transactions by commercial banks amounted to 10.2 billion dirhams, primarily because of the speed-up in hedge operations in July 2008 induced by the Eurodollar's increased volatility further to the tightening of ECB monetary policy.

However, these currency purchases were totally offset by the sales of foreign bank notes, the pace of which accelerated through summer vacations, reaching 12.5 billion dirhams. Also, the expansive effect of net foreign assets (NFA) on liquidity amounted to 2.4 billion dirhams.

Altogether, in the third quarter of 2008 autonomous factors exerted a restrictive effect of 6.4 billion dirhams on banks' liquidity. Moreover, the increase in reserve requirements, primarily attributable to the increase in deposits, totaled 1.4 billion dirhams.

Chart B 4.5: BAM interventions on the money market (in millions of dirhams)

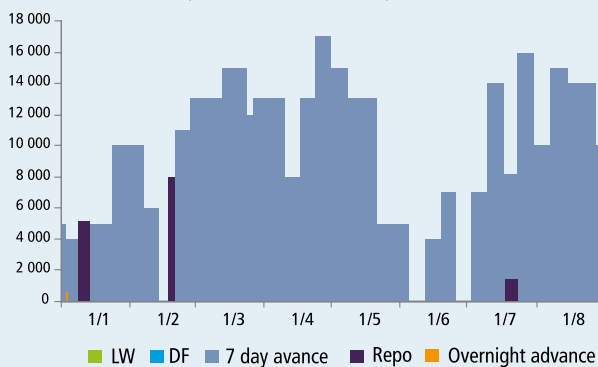
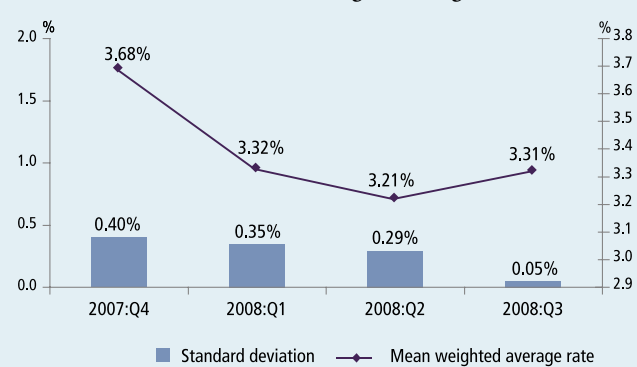


Chart B 4.6: Change in the mean and standard deviation of the interbank market weighted average rate



4.1.2 Money, credit and liquid investments

M3 growth

Annual growth of money supply continued to slow in the second quarter of 2008. Consequently, money surplus, whose volume further decreased, fell slightly below the average of the last eight quarters, both for M1 and M3 aggregate.

In July 2008, M3 annual growth fell to 12.2% after an average of 13.8% in the first half-year, mainly because of the downward adjustment of the growth pace of the most liquid components included in the M1 aggregate.

While annual growth pace of paper currency slowed down somewhat, bank money saw a strong deceleration, falling to 8.1% in July instead of 16.1% in the previous quarter and more than 20% on average in 2007.

The moderate growth in bank money is attributable, in part, to the large switching movements of nonfinancial agents' surplus money holdings, accumulated in 2007, to monetary UCITS and time deposits.

The latter registered an annual growth of 12% in the second quarter and 27.4% in July, concurrently with the rise in their interest rates, which was linked in part to the persistence of bank requirements for sustainable supply of liquidities.

Bank loans

In the second quarter of 2008, bank credit¹ grew by 7.5% from one quarter to the next and by 28.7% on a year-to-year basis, at the same pace as that observed over the last two quarters. In July 2008, its annual growth marked a deceleration, falling to 25.4%.

The distribution per economic agent still shows the dominance of loans to businesses, thereby bearing witness to the sustained contribution of credit to the strengthening of output and investments,

¹ Bank credit data provided in this Report differ from those published in monetary statistics. Indeed, accounting treatments have been recently carried out to specify the distribution of loans per economic object by means of reclassifying some loans granted to real estate developers under heading «Real estate loans». Before June 2008, some banks classified them under «Cash advances». Corrected data will be integrated in the monthly monetary statistics published by BAM.

Chart 4.3: Change in lending rates

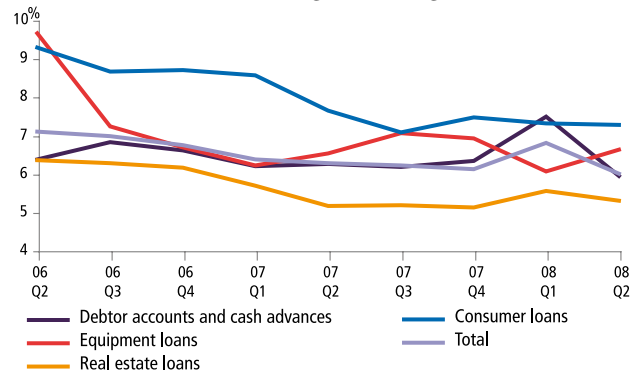


Chart 4.4: M3 annual growth and trend

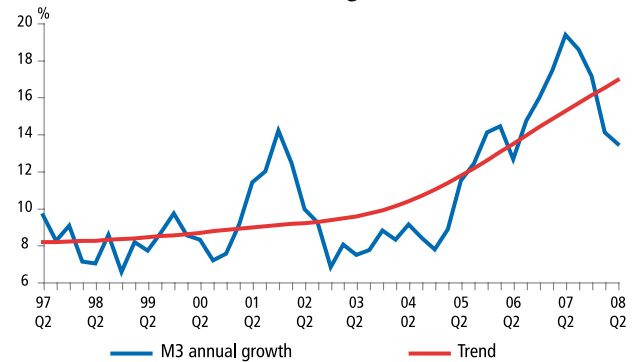


Chart 4.5: Money surplus (in percentage of M3 and M1 equilibrium outstanding amount in real terms)

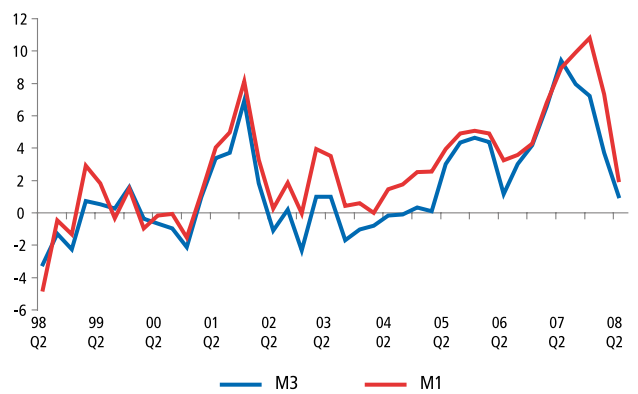
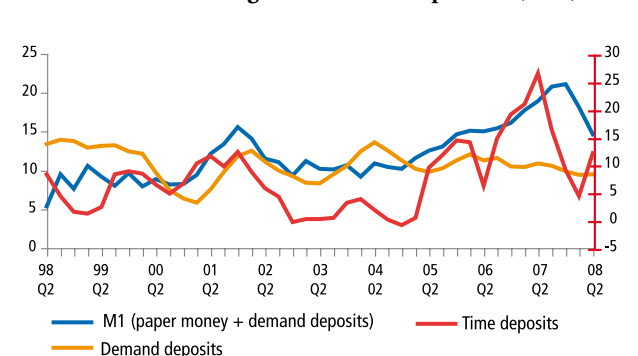


Chart 4.6: Annual growth of M3 components (in %)



notably in the sectors of building and public works and services. The growth pace of loans to businesses could yet be impacted, over the next two quarters, by tightened supply conditions that may be applied by banks, as indicated in the results of the biannual survey on loan granting conditions¹.

Analysis by economic purpose indicates the important share of real estate loans in bank loans' outstanding amount and growth. This category indeed marked an annual rise of 35.8% in the second quarter and 33.7% in July, mainly in connection with robust demand from the building and public works sector. Conversely, demand from private individuals for this category of credit has been falling since the beginning of the year, as reported by BAM survey on loan granting conditions. The sustained strength of real estate loans for several quarters now is also attributable to heightened competition between banks which led to an extension of maturities and increased sophistication of offer. As regards equipment loans, mostly granted to businesses, they maintained a rapid growth rate, keeping pace with the strength in investment.

Cash advances rose by 33.6% on a year-to-year basis in the second quarter, and then slowed down to 30% in July.

Growth in consumer loans, in spite of the slight deceleration registered in July, remained robust, at nearly 37% on a year-to-year basis, in connection with the expansion of demand² and the relatively low level of interest rates.

Loans to finance companies grew at annual rate of 36.2% in July 2008, a rate almost identical to that registered one quarter earlier.

Other sources of money creation

Growth in net foreign assets continued the downward trend observed since the fourth quarter of 2006, coming back to 7.5% in the second quarter of 2008. In line with their usual seasonal profile, foreign exchange reserves recovered from one

¹ BAM biannual survey among banks on loan granting conditions allows gathering information on household and businesses financing conditions for the six-month period under review, as well as on the outlook for the following six-months.

² Based on the results of BAM survey among banks for the second half-year of 2008, this trend is expected to continue in the remainder of the year.

Chart 4.7: Annual growth of nonfinancial agents' demand deposits (in %)

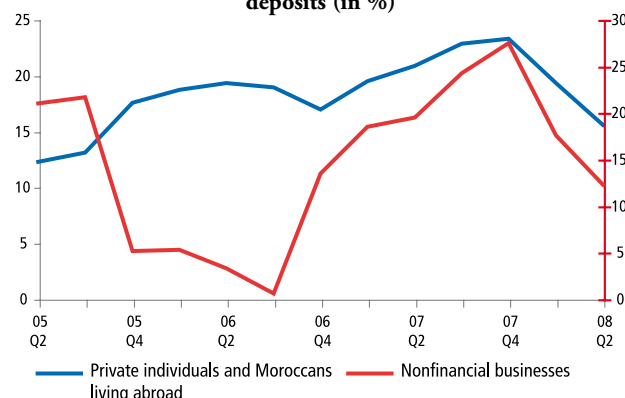


Chart 4.8: Bank loans' annual growth and trend (in %)

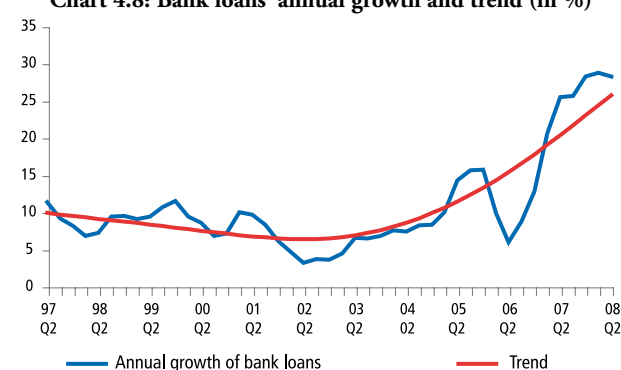


Chart 4.9: Loans' structure per economic agent (in billions of dirhams)

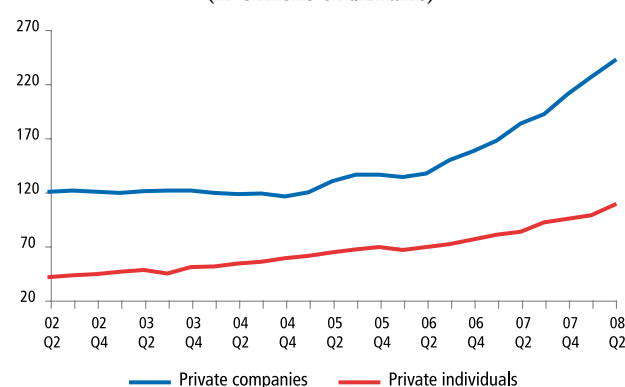


Table 4.3 : Change in the main bank loan categories

	Growth rate in %					
	08:Q1 07:Q4	08:Q1 07:Q1	08:Q2 08:Q1	08:Q2 07:Q2	july-08 june-08	july-08 july-07
Real estate loans	5.9	41.4	6.4	35.8	2.4	33.7
Equipment loans	7.2	31.5	2.6	31.1	0.5	26.0
Cash advances	3.7	25.0	15.2	33.6	-0.1	30.0
Consumer loans	6.6	39.9	8.2	38.1	3.2	36.4

month to the next in July, but their annual growth pace remains limited due to the deterioration of trade deficit and, to a lesser degree, the contraction of proceeds from tourism and Moroccans living abroad from one year to the next.

Net claims on the Government contracted in the second quarter and in July 2008, falling back to 14.3%, a level below that observed in July 2007. This fallback essentially reflects the continued reduction of Treasury debt towards banks, with its net position with regard to Bank Al-Maghrib having remained virtually unchanged compared to the same period in the previous year.

Altogether, the contribution of other sources of money creation to money supply growth continued to weaken to the benefit of bank loans.

Liquid investments

After a long cycle of slowdown and four consecutive quarters of decline, liquid investments improved in the second quarter and July 2008 marking annual growth rates of 5.8% and 3.3%, respectively. Since the third quarter of 2007, these investments have been basically fuelled by their most liquid component, securities of monetary UCITS, whose outstanding amount stood at 20.8 billion in July 2008 instead of only 11.9 billion a year before.

On the other hand, the outstanding amount of bond UCITS securities fell to 19.6 billion in July 2008 against 26.7 billion in the same month of 2007, thus reducing its share in the overall liquid investments from 60% to 40%. This change is explainable by the low volume of activity on the Treasury bill market.

Securities of equity and diversified UCITS grew at paces near to only 18% in the second quarter and in July, as opposed to an average of 84% in 2007, due to the fall in the annual performance of prices on the Casablanca stock market.

4.1.3 Exchange rates

At the end of the second quarter of 2008 and in comparison to the previous quarter, the national currency on average appreciated by 4% against the

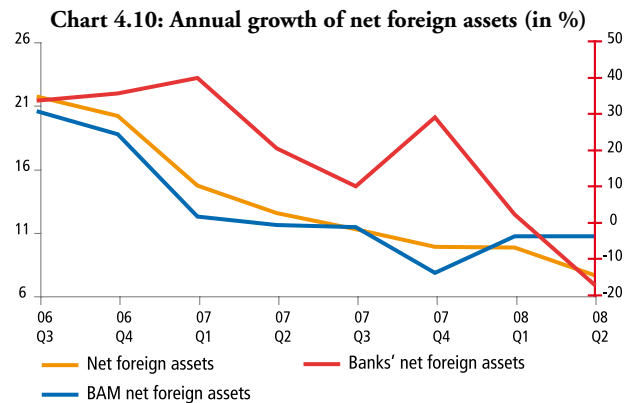


Chart 4.11: Quarterly change in net claims on the Government (outstanding amount in billions of dirhams)

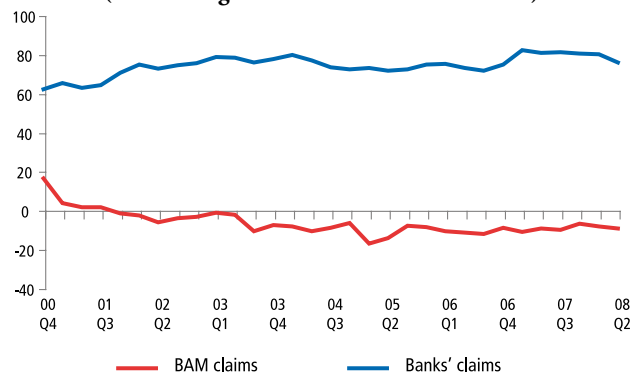


Chart 4.12: M3 growth breakdown per main counterparts

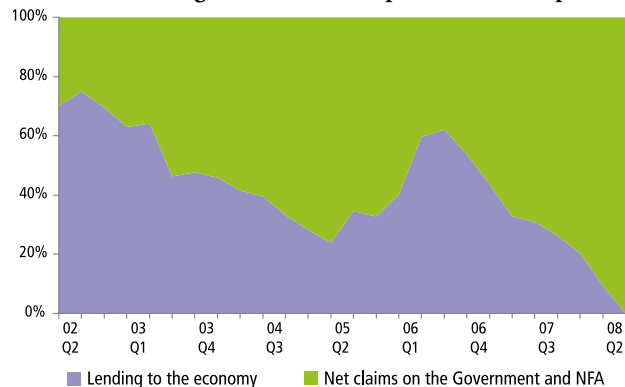
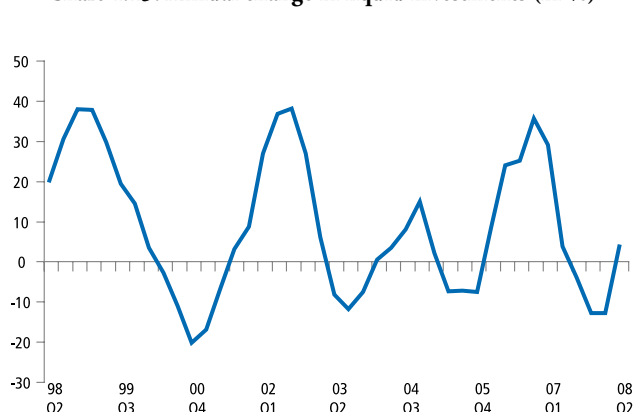


Chart 4.13: Annual change in liquid investments (in %)



pound sterling, 3.51% against the dollar, nearly 3% against the yen and 0.12% against the Swiss franc. On the contrary, it depreciated by 0.66% against the euro.

This trend reversed in July and August. The national currency on average was 0.25% up against the euro and 1.32% down against the dollar.

The dirham's nominal effective exchange rate, based on bilateral exchange rates with regard to Morocco's major partners, increased by 0.14% in comparison with the previous quarter, due to the appreciation of the dirham against some currencies that offset its depreciation against the euro. At the same time, the unfavorable trend in the inflation differential led to a rise in the real effective exchange rate by 1.33% compared to the last quarter.

4.2. Asset prices

At the end of the second quarter of 2008 and contrary to the previous quarter, the MASI index was down by 3.4%, bringing its performance since the turn of the year to 11.8%. This annual growth remains largely below that reported by the index in the same period in 2006 and 2007 when it stood at 29.5% and 21%, respectively. Likewise, the real estate sector index registered a negative performance of 0.3%. At the end of July and August, the downward trend of both indexes continued with decreases of 1.4% and 0.2%, respectively.

The volume of transactions dropped substantially by about 39.1%, to 41.2 billion dirhams. At the end of the first two months of the third quarter of 2008, stock market turnover remained relatively limited, with an overall volume of approximately 29 billion.

Stock market capitalization also registered a decline of 2.7%, totaling 660.8 billion dirhams. Furthermore, listing on the stock market of three new companies in the previous quarter brought the number of listed shares as at the end of June to 78. At the end of August, stock market capitalization improved slightly, standing at 662.5 billion dirhams.

Chart 4.14: Change in monetary and bond UCITS securities (in millions of dirhams)

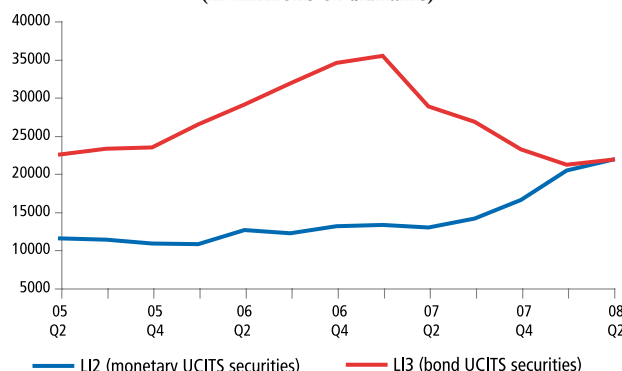


Chart 4.15: LI4 and Masi (year-to-year in %)

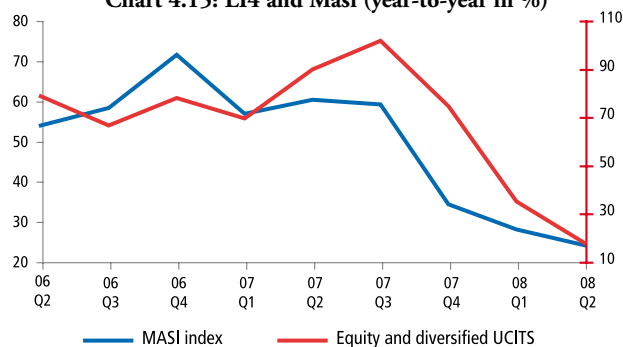
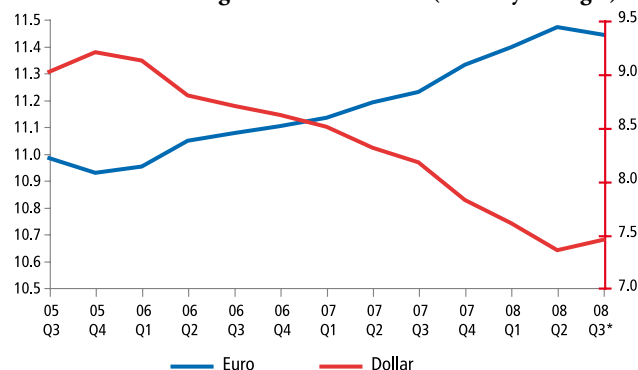
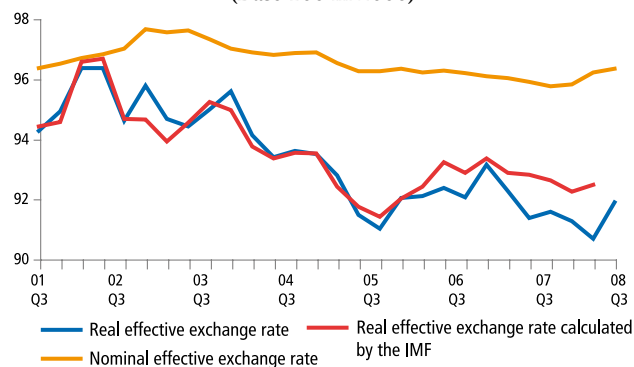


Chart 4.16: Exchange rate of the dirham (monthly averages)



* 2008: Q3 corresponds to the arithmetic average of July and August data.

Chart 4.17: Nominal and real effective exchange rate (Base 100 in 2000)



Source: BAM and IMF calculations

PER on the Casablanca stock market fell from 21.2 to 20.1 from one quarter to the next, particularly in connection with the stock market price correction. This level yet remains elevated compared to that registered on other stock markets.

Concerning real estate assets, the cross-checking of the fragmented information gathered tends to show that their prices remain elevated. The persistence of a strong demand for low-cost and luxury housing and the high level of interbank competition on housing loans, henceforth a product to attract customers and secure their loyalty, should everything else being equal maintain the strength of this market.

Given the usual risks linked to the development of this market, last May Bank Al-Maghrib contributed to a code of ethics to encourage sound real estate financing (see Box 4.2).

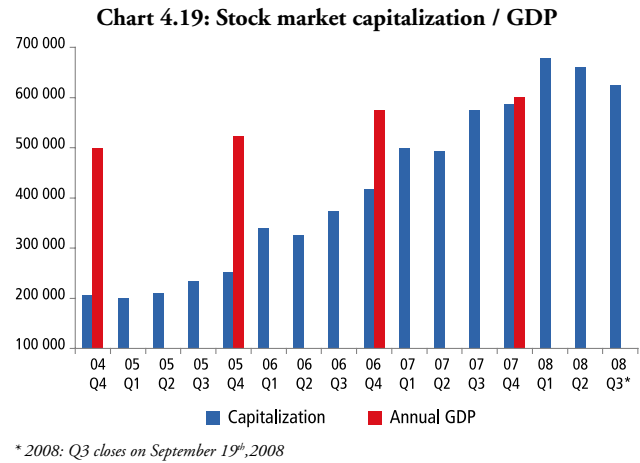
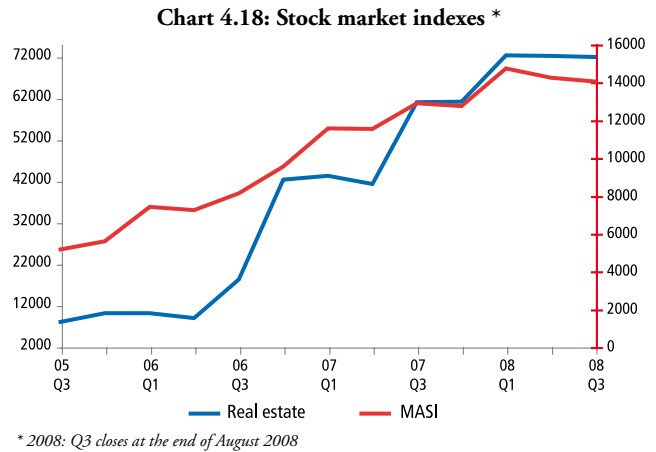


Table 4.4: Equity market valuation (PER)

	07:Q2	07:Q3	07:Q4	08:Q1	08:Q2
Casablanca Stock Exchange	20.5	22.9	22.2	21.2	20.1
Euro stoxx 50	13.6	12.9	12.5	10.5	11.14

PER: Price Earnings Ratio
Sources: Bloomberg and CFG

Box 4.2: Main provisions of the code of ethics on financing real estate assets adopted in May 2008

To ensure a sound and solid development of real estate financing, credit institutions, in cooperation with Bank Al-Maghrib, agreed on setting up a code of ethics relative to real estate financing.

The ethical rules and principles that credit institutions must observe to ensure sound and appropriate financing of real estate assets focus on the following axes:

- Bank/customer information: banks must inquire about their customers' situation, particularly their financial situation, assets and occupation, as well as their needs and constraints. Banks should also inform their customers, in a transparent and faithful manner, on the services and products offered.
- Compliance with the financing conditions of real estate assets, both for home purchase loans and real estate development loans. For this purpose, credit institutions must abide by the directive of Bank Al-Maghrib relative to the minimum elements to be required as part of examining loan applications. They must also ensure that loans are not granted for the purchase of low-cost homes by non approved customers, the purchase of several low-cost homes by a single customer or the purchase of land for speculative purposes.
- Advertising, communication and adherence to competition good practice while advertising their financing products and prices in an honest and faithful manner.
- Distribution of the code of ethics by credit institutions to their staff members and subsidiaries operating on the real estate market, making sure the rules are entirely respected.
- Constitution of a monitoring committee consisting of representatives of Bank Al-Maghrib and the Moroccan Bankers' Association, which will see to the implementation and improvement of the code provisions.

5. RECENT INFLATION TRENDS

Under the effect of increasing pressures on prices attributable to external and internal factors, headline inflation stood at 5.1% in July 2008 on a year-to-year basis, as opposed to 4.7% in June and 5.4% in May. This speed-up is linked to price rises for fresh produce, the continued pressure on food staples and the rise in the prices of some types of fuel. Core inflation continued to register high levels but is showing slight easing, standing at 4.7% against 4.8% in June and 4.9% in May. The distribution of inflation per type of product reveals the continued spread effect of price rises in tradables to nontradables, in particular services, at a relatively steady pace over the past four months. Pressures on prices were also perceptible on industrial producer prices, with the index of manufacturing industries rising by 28.2% after an increase of 26.5% in June. Indeed, and taking account of the rise in import prices, the cost of inputs for manufacturing enterprises registered a hefty rise carried over to industrial producer prices, particularly in the refining, food, chemical and metallurgical industries.

5.1 Inflation trends

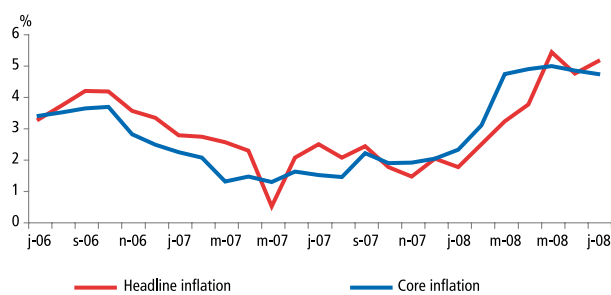
In spite of signs of easing in the prices of food staples in July 2008, headline inflation reached a high level on a year-to-year basis, with the rise in the cost of living index settling at 5.1% instead of 4.7% in June and 5.4% in May. Fresh produce, which constitute 20.1% of the index basket, contributed by about 1.5 percentage point to headline inflation. The contribution of food staples, which represent 15.2% of the CLI basket, stood at more than 2.3 points, while that of private transport neared 0.2 point. The core inflation indicator calculated by BAM registered a growth of 4.7% instead of 4.8% in June.

The gap between headline inflation and core inflation stood at 0.4 percentage point, in particular due to the 6.5% increase in the prices of fresh produce as opposed to 4.9% one month earlier.

Indeed, the price of vegetables and fresh fruit rose by 9.2% and 7.2% against 3.6% and 5.3%, respectively. The rise in the growth pace of the prices of these products is mostly attributable to the basic effect resulting from the large drops registered in July 2007.

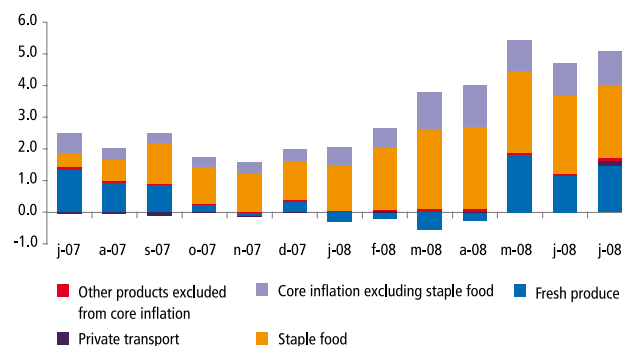
Similarly, private transport fares, the trend of which is dependent on fuel prices, registered a rise of 6.1% instead of 0.5% in June, mainly because of the rise in the domestic prices of certain types of fuel, in particular premium gasoline that is included in the composition of transport index. The Brent barrel price observed on international markets indeed exceeded 130 dollars in July, a price largely above the assumptions of the Finance Act of 2008.

Chart 5.1: Headline inflation and core inflation (year-to-year)



Sources: HCP, BAM estimates

Chart 5.2: Contribution of the main components to year-to-year headline inflation (in percentage points)



Sources: HCP and BAM estimates

Further, the increase rate of food staple prices, although in slight decline from 18.2% to 17.1%, remains elevated. This contributes to holding core and headline inflation at high levels. In fact, the calm in prices observed on international markets for certain foodstuffs has not yet been totally reflected on domestic prices, as the majority of import contracts are signed in advance and do not take account of recent price trends on international markets.

5.2 Goods and services

The distribution of inflation per type of product showed relative mitigation in the increase rate, on a year-to-year basis, of prices for processed goods, falling from 4.5% in June to 4.2% in July. This trend basically results from the deceleration in the prices of certain food staples, in particular dairy products (from 6.9% to 4.5%) and fats (from 24.3% to 22.2%).

As for prices of “unprocessed goods and others”, they registered substantial rises (from 8.5% to 9.8%) primarily further to price hikes of certain types of fresh produce, particularly fish, fruit, and vegetables.

In addition, the pace of price rises for services excluding private transport stabilized at about 1.4% for the fourth consecutive month since April 2008. This situation reflects, on one hand, an acceleration in prices for “medical consultations” and “restaurants, cafés and hotels”, and on the other hand a deceleration in prices for “communications”, “education” and “maintenance and repairs”.

The continued slowdown in the increase rate of processed goods’ prices and the stable trends in the prices of services excluding private transport made it possible to further reduce the relative gap between both indexes. It was of approximately 3.2 percentage points in May before returning to 3.1 points in June and 2.7 points in July 2008.

This gap could contract even further starting the fourth quarter of the year, under the effect of wage adjustments that impact the prices of services more than those of goods.

Table 5.1 : Headline inflation and its components

	Monthly change (%)			year-to-year (%)		
	May 08	June 08	July 08	May 08	June 08	July 08
Headline inflation	0.9	-0.3	0.2	5.4	4.7	5.1
- Fresh produce	4.6	-2.1	-0.5	8.0	4.9	6.5
- Private transport	0.1	0.0	5.6	0.5	0.5	6.1
- Other products excluded from core inflation	0.0	0.0	0.1	0.8	0.8	1.0
Core inflation	0.2	0.2	0.1	4.9	4.8	4.7
Including:						
- Staple food	0.3	0.2	-0.1	19.4	18.2	17.1
- Other food products	0.3	0.9	1.0	1.9	2.7	3.7
- Clothing	-0.1	0.1	0.1	1.6	1.5	1.6
- Housing	0.1	0.1	0.1	0.7	0.7	0.7
- Equipment	0.1	0.3	0.4	2.7	2.9	2.8
- Medical care	0.0	0.0	0.1	0.3	0.3	0.3
- Public transport and communications	0.0	0.0	0.0	1.9	2.0	1.9
- Leisure activities and culture	0.1	0.0	0.1	1.9	1.9	1.8
- Other goods and services	0.2	0.1	0.2	2.6	2.5	2.5

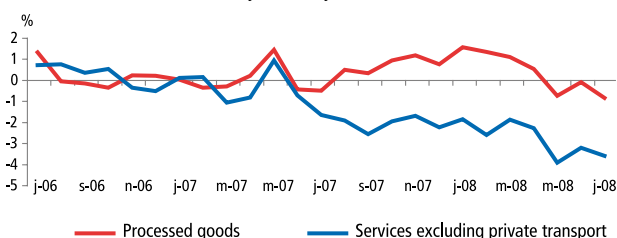
Sources: HCP, BAM estimates

Table 5.2: Price indexes for goods and services

	Monthly change (%)			Year-to-year change (%)		
	May 08	June 08	July 08	May 08	June 08	July 08
Processed goods	0.3	0.2	0.0	4.6	4.5	4.2
Unprocessed goods and others	3.1	-1.4	-0.2	11.0	8.5	9.8
Services excluding private transport	0.1	0.1	0.1	1.4	1.4	1.4
Private transport	0.1	0.0	5.6	0.5	0.5	6.1

Source: BAM estimates

Chart 5.3: Relative prices of processed goods and services excluding private transport in comparison to headline inflation (year-to-year)*



(* Gap between the inflation rate of processed goods and services excluding private transport and headline inflation rate.

Sources: HCP, BAM estimates

The overall contribution of processed and unprocessed goods to headline inflation on a year-to-year basis was of approximately 4.1 points in June and 4.3 points in July. Services, including private transport, contributed to headline inflation by 0.6 point in June and 0.7 point in July.

5.3 Tradable and nontradable goods

After having experienced a slowdown from 8.9% in May to 7.4% in June, prices of tradable goods again increased in July, by 8.1%. Thus, the contribution of tradable prices to inflation was of approximately 3.5 percentage points. In view of the deceleration of commodity prices' growth pace in July, the accelerated rise in the prices of tradable goods is mainly attributable to the basic effect that pushed up the prices of some fresh produce, in particular fruit and vegetables.

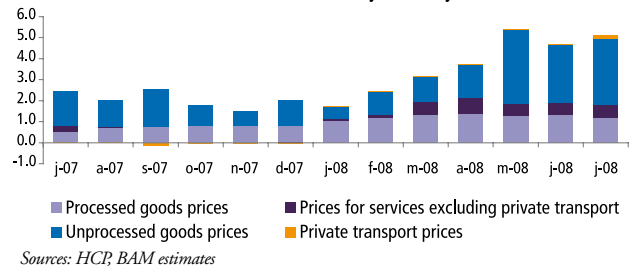
The rise in inflation was also fuelled, but to a lesser degree, by nontradables sector where prices rose by 2.7% instead of 2.4% in the previous month, thereby contributing to headline inflation by 1.6 percentage point. Indeed, price increase rate in the nontradables sector remained at 1.6%, almost the same pace of growth as in previous months. In spite of this stabilization, a spread effect to the prices of nontradables is noticeable, especially in some services such as "restaurants, cafés and hotels", "medical consultations" and "private transport". However, the effect of the said rises was mitigated by stagnation in the increase rate of meat prices and the deceleration in communication prices.

In light of recent trends, prices for tradable and nontradable goods remain dependent on uncertainties linked to pressures on oil prices and food staples, as well as on the effect of wage readjustments entering into force as of July 2008.

5.4 Industrial producer price index

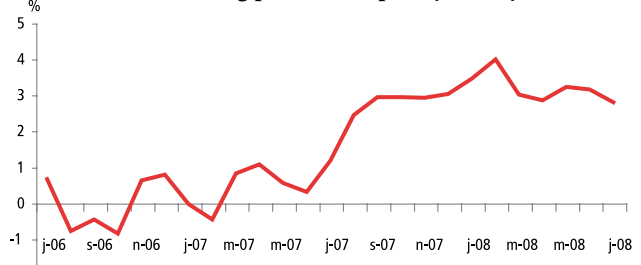
Cost-driven inflationary pressures are highly perceptible at the level of industrial producer prices. Indeed, the price index for manufacturing industries in July 2008 registered a sharp rise of 28.2% after 26.5% the previous month. This change is largely due to the 64.4% increase in oil refining

Chart 5.4: Contribution of goods and services prices to headline inflation (year-to-year)



Sources: HCP, BAM estimates

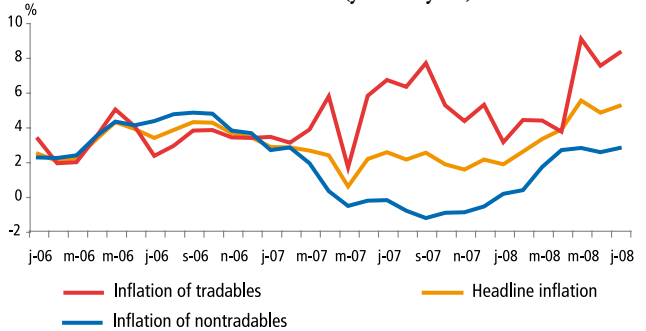
Chart 5.5: Gap in inflation rates between processed goods and services excluding private transport (year-to-year)*



(* The gap between the inflation rate of processed goods and of services excluding private transport

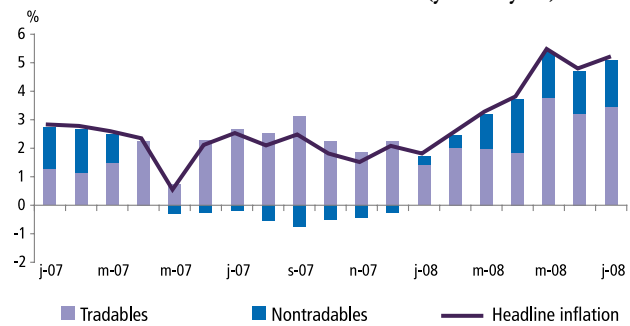
Sources: HCP, BAM estimates

Chart 5.6: Change in the indexes of tradables and nontradables (year-to-year)



Sources: HCP, BAM estimates

Chart 5.7: Change in the contribution of tradables and nontradables to headline inflation (year-to-year)



Sources: HCP, BAM estimates

prices, under the effect of the 73.4% hike in the Brent barrel price on international markets, thereby contributing by more than 17 percentage points to growth in the overall index.

In this respect, the expectations of market operators suggest a drop in future prices of the Brent barrel. Actually, the expected slowdown in economic activity in the fourth quarter of the current year could pull energy consumption of industrialized countries downwards.

Excluding refining activities, producer prices in manufacturing industries also registered a rise from 14% to 14.8%. This reflects the significant rises in producer prices in most industrial branches.

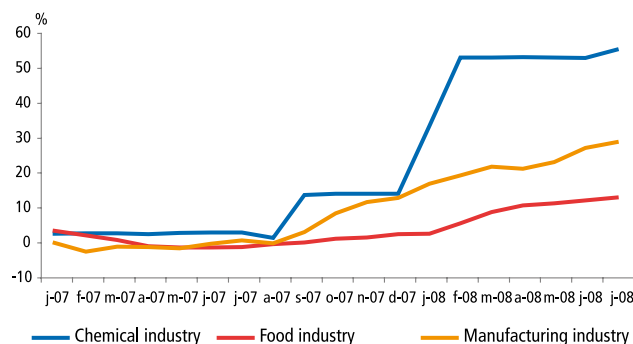
Therefore, price rise in the food industry rose from 11.5% in June to 12.3%, thereby contributing by 2.9 percentage points to the increase in the manufacturing index. The relative calm in soaring world prices for basic agricultural commodities has not yet been reflected in ex-works prices.

At the same time, the continued rise in chemical and oil input prices impacted the chemical branch, the prices of which grew by 54.6% instead of 52.2% in June, thus contributing by 7 percentage points to the rise in the benchmark index.

Concurrently, the rise in output costs for metallurgy rose from 7.3% to 9.9%, while for metal working it stood at 9%, the same rate registered one month previously. This trend stems from the soaring prices for aluminum, copper and zinc.

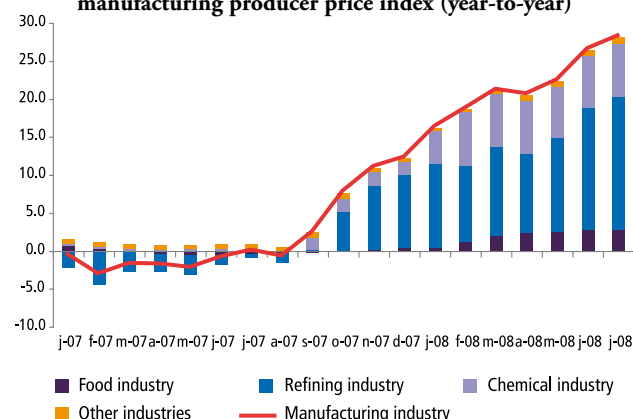
However, quotations on the futures market of these metals suggest a sharp drop in prices in the short term. The contraction of demand induced by the expected slowdown in activity and the increased supply of these metals are all factors that could cause prices to ease. On the other hand, producer prices in the textile industry fell by 0.2%, after 0.7% in June.

Chart 5.8: Change in industrial producer price indexes (year-to-year)



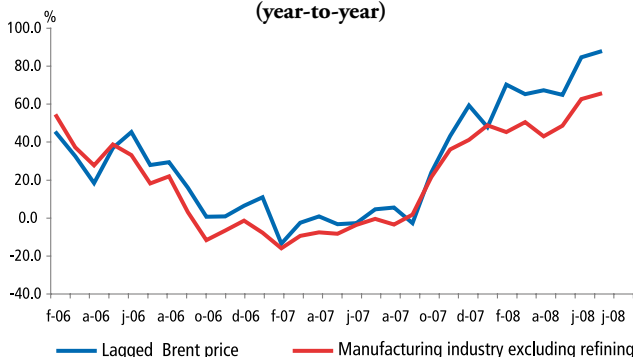
Source: HCP

Chart 5.9 : Contribution of the main headings to manufacturing producer price index (year-to-year)



Sources: HCP, BAM estimates

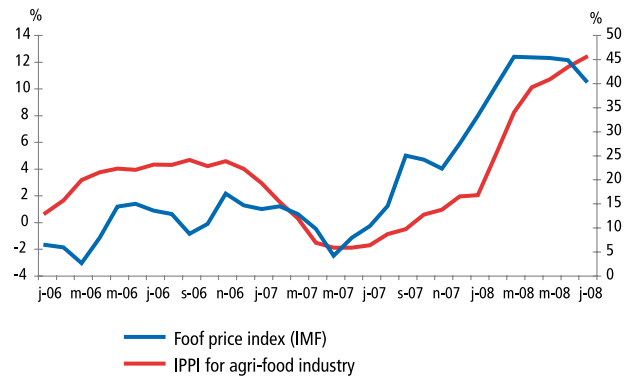
Chart 5.10: Refining industry index and Brent price (year-to-year)



Sources: IMF, HCP and BAM estimates

The results of the July BAM business survey confirm the continuation of recent trends in industrial producer prices, as the outlook of business managers in terms of the change in finished product prices remains on an upward slope for the three forthcoming months.

Chart 5.11: Change in food prices in Morocco and on international markets (year-to-year)



Sources: IMF, HCP and BAM estimates

6. INFLATION OUTLOOK

This section presents the inflation trend deemed to be the most probable (central forecast) over the next six quarters and examines the major risks associated thereto (balance of risk). The central forecast scenario is therefore dependent on the assumptions and trends envisaged for a series of variables affecting activity and inflation. On the assumption of non-occurrence of the main risk factors identified, the central inflation forecast for the next six quarters on average hovers around 3.8%. At the end of 2008, inflation is expected to reach 3.9%, above the forecast outlined in the last MPR (2.7%), while the year 2009 would see an average inflation of approximately 3.6%. For the third quarter of 2008, we expect a rebound in inflation by about 4.6%, mostly fuelled by the rise in food and energy prices. This sustained pace in price rises is expected to continue to the fourth quarter of the current year with a central inflation projection of 4.2%. Compared to the previous Report, inflation forecast was revised upwards given the materialization of some risks over the past few months. In the quarters to come, the risks and uncertainty surrounding the central inflation forecast still remain on an upward slope. Externally, they are linked to future change in oil and agricultural commodity prices. Internally, they result from uncertainties about the changes that will be made to the range of subsidized petroleum products, loans' growth pace that remains high, as well as the anticipated effects of the rise in the minimum wage on salaries.

6.1 Baseline scenario assumptions

6.1.1 International environment

World economy is currently going through a critical period characterized by a sharp slowdown of activity in both emerging and developed countries. For the second time this summer, 2008 growth forecasts for the main economic areas, with the exception of the United States, were revised downwards by most international institutions. OECD henceforth expects a growth rate of approximately 1.3% for the Eurozone and 1.8% for the United States, instead of the previous 1.7% and 1.2%. However, a slight recovery is expected for next year.

The relative optimism concerning the United States is mostly explainable by the recent tax incentives granted by the U.S. Administration, thereby fostering the strength of domestic demand, as well as by the good performance of foreign trade due to the dollar's weakness. However, the tightening of credit, the persistent difficulties in the financial system, and their macroeconomic effects are all indicators suggesting risks on the strength of consumption expenditure of U.S. households.

In the Eurozone, and similarly to the United States, the current crisis in the housing market has led to a drop in prices, a relative stabilization

of the building and public works sector, and a tightening of loan-granting conditions. In addition, European countries are currently undergoing the effects of the financial crisis caused by the securitization of subprime mortgages; a crisis that has mainly resulted in substantial losses for commercial banks.

In view of these recent developments, we assume as a central forecast a growth rate in our major partner countries (France, Germany, Italy and Spain) of 1.1% in 2008 and 1.3% in 2009. This constitutes a substantial slowdown compared to the prediction of the previous MPR, where our growth assumption was of 1.6%, while the 2009 forecast remains unchanged. It is worth mentioning that this growth rate is calculated on the basis of a weighted average of growth rates in our main partners.

The major causes of the weak growth of our main trade partners also include the high commodity and energy prices on international markets, affecting inflation in all these countries. Therefore, core inflation rates have increased in gradual but constant manner over the past two years and headline inflation is currently up, standing at 3.8% for August of this year.

Since the last Monetary Policy Report, the pace of increase in international prices of major commodities has slowed down, though at a rate largely below the forecasts of last June.

In spite of the drop in global economic activity and fears of recession in certain countries, as is reflected by the recent easing in the prices of major commodities, the increase rate of import prices in Morocco for the current year would be high. The pace of increase should, however, slow down in 2009. Altogether, import price-driven inflationary pressures remain at very high levels.

6.1.2 National environment

The assumption of a cereal harvest of 50 million quintals, made in the last MPR, was confirmed following the publication by the Ministry of Agriculture of the final results of cereal output for 2007-2008. These figures show an output of about 51 million quintals, a yield below the level considered as average of 60 million quintals, representing more than twice the 2006-2007 harvest. Agricultural value added therefore grew by 10.2% and then 9.6% in the first and second quarters of the current year. For the crop year of 2008-2009, the adopted scenario is that of an average cereal output of 60 million quintals, corresponding to a rise in agricultural GDP of approximately 8%. In these conditions, the agricultural output gap is expected to remain positive over the last two quarters of 2008, and also during the next year. This trend is largely attributable to the agricultural production assumed in our central scenario. In conclusion, in our central scenario we expect the continuation of growth in non-agricultural sectors on a trend similar to that registered over recent quarters.

Non-agricultural activities led to an improvement in the rate of unemployment at the national level, which fell from 9.4% in the first quarter of the current year to 9.1% in the second quarter (on a year-to-year basis). Hence, job creation primarily concerned urban areas and more specifically the sectors of services and building and public works. Rural areas registered a negative performance with an increase in unemployment reaching 3.9% against 3.4% one year earlier. On the assumption of an average crop year in 2008-2009, we predict a strengthening of labor supply that will inevitably benefit from the expected recovery of the agricultural sector, thus suggesting a better outlook for the remainder

of 2008 and beginning of 2009 (at least with regard to rural employment). Eventually, this improvement would yet induce additional inflationary pressures given the higher labor cost.

The Quarterly Wage Index, calculated by HCP on the basis of CNSS data (private sector), shows an increase in real wages of about 5% in the first quarter of this year, after a significant drop of 3.5% in the fourth quarter of 2007. Following the Government's decision to increase the minimum wage, we then assume for this forecast exercise two 5% increases in the minimum wage occurring in July of this year and July of 2009. It should be noted that the impact of minimum wage readjustment on the average level of salaries and on inflation is significant and long-lasting, as demonstrated by a study whose conclusions were published in the June MPR.

The pressures observed in international oil markets slightly eased at the beginning of the summer, further to the multiplication of indicators suggesting a drop in consumption in most parts of the world. In fact, oil prices decreased by almost 40 dollars, falling below the \$105 mark in the first week of September. Although producer countries' room for maneuver in terms of spare capacities are very narrow, as reflected by analysis of world supply and demand for petroleum products, the recent geopolitical disturbances in Georgia and weather hazards were not able to push oil prices up to levels similar to those registered at the beginning of summer. The relative insensitivity of prices to these shocks is mostly attributable to the global recession, but also to the change in the euro-dollar parity. However, the continuation of pressures on oil prices might persist. Most specialized international institutions have revised their price projections upwards since the last MPR. The IMF henceforth predicts a higher average price of barrel (basket) at \$116.50 in 2008 and \$125 in 2009.

In Morocco, the freezing of the indexation mechanism has so far made it possible to preserve the domestic market against the effect of these rises on prices at the pump. The costs of petroleum products' subsidization are growing sharply, as they increased by 21% in 2007 to

10.3 billion dirhams, against 12% in 2006. In the framework of the Finance Act of 2008, it was planned to devote thereto a total amount of 8.7 billion dirhams, excepting arrears, on the basis of an optimistic scenario of \$75 per barrel, that is a rise of 50% compared to the Finance Act of 2007. The overall budget allocated to subsidization has since then increased, by decree, by 14 billion dirhams¹. Bank Al-Maghrib simulations relative to subsidization costs for this year show that they will waver between 9.5 and 11 billion dirhams for the first eight months of 2008 just for diesel, i.e. between 109.2% and 126.4% of the budgeted amount for all petroleum products.

The current price level on the international market, above \$75, should therefore lead to a rise in the domestic price of diesel fuel, if the indexation mechanism is fully applied. We yet expect that this mechanism will be kept in place for the remainder of the year. However, the project for reshaping the subsidization system together with the introduction of diesel 50 ppm suggest that diesel prices at the pump will most likely be adjusted upwards in 2009. The central forecast thus assumes stagnation in diesel prices at the pump in 2008 at 7.22 dirhams per liter, followed by a rise of about 14% in the first quarter of 2009, equal to 1 DH/l, i.e. a price of 8.22 dirhams per liter.

6.2 Inflation outlook and balance of risks

Bank Al-Maghrib, as part of this MPR, presents an inflation forecast at a fixed interest rate (fixed key rate) over 6 quarters. The extension of the forecast horizon should make it possible to have better visibility on the future development of inflation.

On the assumption of the non-materialization of the major risks discussed hereafter, the central forecast over the next six quarters suggests a price level higher than those registered in the past few years. At the end of 2008, headline inflation would most certainly stand at a level substantially above that of 2007, increasing

from 2.1% to 3.9%. Compared to the projections given in the last Monetary Policy Report, average headline inflation for the last two quarters of the current year was revised upwards from 2.1% to 4.4%, together with the annual projection for 2008, which was increased from 2.7% to 3.9%. For 2009, the central forecast indicates a potential inflation rate of approximately 3.6%.

Headline inflation will thus increase significantly in the current quarter, reaching 4.6% before falling to 4.2% at the end of the fourth quarter of 2008. It will be mostly driven by the continued progressive repercussion of the spread effect of tradables' higher prices to nontradables, primarily services. For the four quarters of the year to come, we project an inflation rate of about 4.1% (instead of 2.4% previously), 3.4%, 3.2% and 3.5%, respectively. These high levels would be attributable in part to a phenomenon of imported inflation (see Table 6.1).

Table 6.1 : Inflation central forecast for 2008 Q3 - 2009 Q4

Year-to-year	2008		2009			Average		
	Q3	Q4	Q1	Q2	Q3	Q4	2008	2009 FH*
Central forecast (%)	4.6	4.2	4.1	3.4	3.2	3.5	3.9	3.6 3.8

BAM forecasts

*(FH) Forecast horizon

Compared to the projections published in the Monetary Policy Report of June 2008, the inflation forecast for the last two quarters of the current year was adjusted upwards from 2.5% to 4.6% and from 2.4% to 4.2%, respectively.

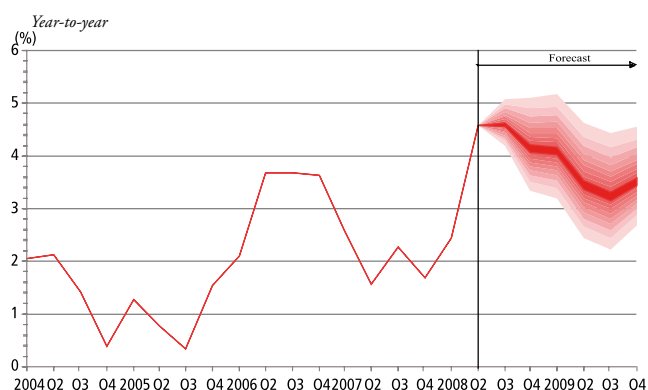
These projections have been developed on the basis of assumptions considered as being the most probable. However, there are still many sources of uncertainty stemming from future trends in exogenous variables as well as from the forecasting models which may impact the projected inflation rate either upwards or downwards. Analysis of the balance of risks shows an asymmetric forecast range represented in the form of a fan chart. This is a probabilistic evaluation of uncertainty zones surrounding the central forecast (see Chart 6.1). The fan chart of this forecast exercise suggests a very slight

¹ Official Bulletin of July 10th, 2008

upward asymmetry denoting the existence of a probable rise in headline inflation compared to the central forecast.

Uncertainties surrounding the future change in a certain number of inflation determinants, as well as the nature of risks that could impact this change, have led to a fan chart wider than the probabilistic representations outlined in the preceding MPRs. This asymmetry stems, on one hand, from the risks linked to the uncertainties surrounding the development of the international economic situation (growing uncertainties over the future trend of hydrocarbon prices and agricultural product and commodity prices; incomplete specification of the main axes of Morocco's future energy policy; as well as a higher inflation rate in our major trade partners) and, on the other hand, from the risks linked to the national environment: uncertainties about medium-term sustainability of the subsidization system; lack of visibility as to the production of future crop years; high growth rate of credit, though on a slowdown trend; in addition to the expected repercussions of the rise in the minimum wage on inflation. The materialization of one or more of these risks could lead to an inflation rate above the central forecast, at a value included (with a probability of 90%) within the forecast range represented on the fan chart.

Chart 6.1 : Inflation forecast fan chart, 2008 Q3 - 2009 Q4
(Quarterly data)



(*) The chart represents the confidence interval relative to inflation projections derived from the baseline scenario (dark red). Confidence intervals from 10% to 90% are also reported. Each addition of intervals of the same color, on both sides of the central forecast, increases by 1.0% the probability that headline inflation would fall within the range delimited by these intervals. Therefore, if we consider the range delimited by the fifth interval around the central forecast, this means that we have a 50% chance that inflation will fall within this range in the future.

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